UNITED STATES DISTRICT COURT
SOUTHERN DISTRICT OF NEW YORK

JINO KURIAKOSE, Individually and On Behalf of All Others Similarly Situated, Plaintiff, vs. FEDERAL HOME LOAN MORTGAGE COMPANY, RICHARD SYRON, PATRICIA L. COOK, and ANTHONY S. PISZEL, Defendants.	:	Civil Action No. 1:08-cv-07281-JFK CLASS ACTION

PLAINTIFFS' OMNIBUS OPPOSITION TO DEFENDANTS' MOTIONS TO DISMISS THE AMENDED CONSOLIDATED CLASS ACTION COMPLAINT

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Lead Plaintiff Central States, Southeast and Southwest Areas Pension Fund ("Central States") and plaintiff National Elevator Industry Pension Plan (collectively, "Plaintiffs") submit this memorandum of law in opposition to the motions to dismiss Plaintiffs' Amended Consolidated Class Action Complaint for Violations of Federal Securities Laws ("Complaint") [Doc. #102] by defendants Federal Home Loan Mortgage Corporation ("Freddie" or the "Company"), Richard Syron ("Syron"), Patricia L. Cook ("Cook"), and Anthony S. Piszel ("Piszel") (collectively, "Defendants") (Syron, Cook, and Piszel are the "Individual Defendants"),[1] and state:

I. PRELIMINARY STATEMENT

At a recent hearing, counsel for the Federal Housing Finance Agency ("FHFA"), Freddie's conservator, characterized the present action as a "horrific waste of time" because it represented "an effort by plaintiffs to tap into the federal taxpayers' assets." Such overt contempt for Freddie's common and preferred shareholders – who lost billions of dollars due to Defendants' fraud – is truly astounding.

Defendants' contempt for those shareholders, however, is slightly more subtle. Indeed, rather than accept responsibility for misconduct that gutted Freddie's capital and drove the Company into conservatorship, Defendants place the blame for Freddie's demise solely and squarely on the decline in the U.S. economy. They seek to legitimize this false premise by ignoring the facts in the Complaint, which, among other things, describe how Defendants' actions materially contributed to the current economic crisis. Defendants should not be permitted to hide behind the very economic circumstances they played a substantial role in creating.

To that end, the Complaint expressly recognizes that, at the start of the November 20, 2007 through September 7, 2008 class period ("Class Period"), the turmoil in the residential mortgage markets was adversely impacting Freddie's financial results, leading to a reported $3 billion loss.

[1] Freddie's motion to dismiss is referenced herein as "Def. Mem. at __." The Individual Defendants incorporate by reference arguments raised in Freddie's motion. Where appropriate, the Individual Defendants' motion to dismiss is referenced herein as "I.D. Mem. at __."

The problem here, though, is not with the bare reporting of heavy (and likely continuing) losses. It is Defendants' misrepresentations concerning the true nature and extent of Freddie's impaired financial condition that lies at the heart of the Complaint.

In fact, while Defendants stated that Freddie was taking strong steps to ensure losses attributable to non-prime and non-traditional mortgages loans were limited and would not impair the Company's capital position, the truth was that, due to shoddy underwriting and inadequate due diligence, Defendants caused Freddie to gorge on risky loans that generated tremendous undisclosed losses, which decimated the Company's ability to meet its mandatory capital requirements. Rather than admitting that Freddie had substantial continuing exposure to the non-prime and non-traditional mortgage markets, and that its capital was shrinking, Defendants professed that Freddie was so well-positioned that it could successfully exploit the economic crisis. While competitors were admitting their true exposure and capital issues, Defendants misrepresented that Freddie's superior capitalization would allow it to prosper where those competitors failed, thereby artificially inflating the value of Freddie's equity securities.

Although, as Defendants lament, the Complaint is long, that is a function of the heightened pleading requirements imposed by the Private Securities Litigation Reform Act ("PSLRA"), which require Plaintiffs to plead particularized facts without the benefit of any discovery. For illustrative purposes, the Complaint's fraud allegations during the Class Period can be distilled into the following three examples:

Example 1: Misrepresentations regarding Freddie's exposure to risky non-prime mortgage loans.

> Statement: "We didn't do any subprime business." ¶460.[2] "[W]e didn't buy any subprime loans. . . we weren't in that business" – Syron's statements to investors, December 11, 2007. ¶¶7, 463, 459.

[2] All citations to "¶__" herein refer to paragraphs of the Complaint.

Reality: Freddie ignored stern, repeated warnings from its Chief Risk Officer to stay away from subprime and similar risky loans, firing him instead. ¶¶83-87. From 2002-2007, Freddie dominated purchases of subprime and default prone mortgage-backed securities, "gorging on subprime and Alt-A debt." ¶¶95-97. Freddie secretly "subprimed America," ultimately holding more than $628 billion in toxic mortgages and related securities. ¶161. Defendants used various tricks to conceal from the market the extent of Freddie's risky loan portfolio. ¶¶134-92.

Example 2: Misrepresentations regarding Freddie's capital adequacy.

Statement: "Freddie Mac is not on the threshold of conservatorship because we are adequately capitalized." – Freddie press release, July 11, 2008. ¶7

Reality: Freddie was a "house of cards." ¶13. Although economic data available to Defendants indicated that Freddie's non-prime and non-traditional loan holdings were seriously impaired, Defendants refused to write-down those loans to fair value, thereby hiding losses from investors. ¶¶352-428. Moreover, Freddie padded its capital position by overstating the value of its deferred tax assets. ¶¶429-40. When the U.S. Treasury Department looked closely at Freddie's books, it realized there "just wasn't adequate capital there." ¶13. As Congressional hearings have revealed, Freddie "engaged in creative accounting making it appear [it] had capital that just did not exist." ¶¶84, 301-06.

Example 3: Misrepresentations regarding Freddie's underwriting, due diligence and quality control.

Statement: "During the past year we have taken important steps to address the impact of the declining housing and credit markets to our business. . . . We have begun raising prices, tightened our credit standards and enhanced our risk management practices. – Pizsel statement in November 20, 2007 press release. ¶441.

Reality: Defendants ignored dire warnings about the risks associated with extensive non-prime and non-traditional loans purchases, instead loosening underwriting standards so that Freddie could substantially increase such purchases. ¶¶81-125, 193-210. Defendants undermined due diligence and other quality control efforts that would have mitigated the losses incurred when those loans defaulted at astonishing rates. *See id.*

These allegations do not manifest out of thin air, as Defendants suggest, but are the culmination of a wide-ranging investigation based on numerous reliable sources, which are properly identified and described in the Complaint, and which amply demonstrate that Defendants made material misrepresentations with the requisite state of mind. Taken together, these multiple

corroborative sources paint a disturbing picture of the disconnect between Defendants' false and misleading public statements and Freddie's true financial condition and future business prospects.

Regardless of Defendants' spin, perception, or proclamations of innocence (which continue to this day), what matters here is what is in the Complaint. With the above examples in mind, the Complaint more than adequately satisfies the heightened pleading standards of the PSLRA and Federal Rule of Civil Procedure 9(b). It details the falsity of Defendants' statements with particularity, provides specific facts that, when viewed cumulatively, demonstrate Defendants' scienter, and adequately notifies Defendants of the causal link between the misrepresentations and the claimed losses. Defendants' efforts to strike down the particularized allegations in the Complaint with factual rebuttals and a hodgepodge of legal contentions are unpersuasive and should be disregarded. Accordingly, this Court should deny the motions to dismiss in their entirety.

II. STATEMENT OF FACTS

A. Background

Congress initially chartered Freddie as a government-sponsored enterprise, or GSE, in 1970, establishing it as a for-profit, shareholder-owned corporation. ¶64. Its primary mission is to stabilize and assist the U.S. secondary mortgage market and facilitate the flow of mortgage credit. *Id*. To accomplish this goal, Freddie buys mortgages from primary mortgage lenders, such as banks. Traditionally, Freddie was a low-risk company that backed only the "plain vanilla" end of the mortgage market, concentrating on conventional, 30-year fixed-rate loans to prime borrowers. ¶79.

Freddie operates two channels of business: (1) the Guarantee Portfolio; and (2) the Retained Portfolio. ¶66. In the Guarantee Portfolio, Freddie buys pools of loans from mortgage lenders in exchange for "Participation Certificates" or "PCs." ¶67. Freddie then sells the PCs to investors or holds them in its investment portfolio, and also guarantees the performance of the mortgages underlying the PCs. ¶¶68-70. In the Retained Portfolio, Freddie buys mortgages and mortgage-

backed securities ("MBS") and holds them for investment purposes. ¶71.[3] Freddie buys MBS issued by government agencies (so-called agency securities) or by Wall Street investment banks (non-agency securities). *Id.*

As a GSE, Freddie was subject to specific capital requirements instituted by the government. ¶316. Following an accounting scandal in 2004, the Company's regulator, the Office of Federal Housing Enterprise Oversight ("OFHEO"), required Freddie to maintain a capital surplus of 30% over its minimum capital requirement. ¶¶315-16. The capital requirements were meant to protect the Company against a downturn in housing prices or other financial losses, and were a key financial metric to market participants, directly correlating to the Company's financial health and performance. ¶¶322-41.

B. The Rise and Fall of Non-Prime and Non-Traditional Mortgage Loans

Prior to 2006, the housing market boom was fueled by low interest rates and lenders offering multitudes of loans to high risk borrowers. ¶72. On top of that, lenders increasingly offered risky loan options and borrowing incentives, including "No Income, No Assets," Alt-A and subprime loans, which were designed to increase home ownership opportunities for borrowers with low or damaged credit. ¶73. While risk increased on all fronts, mortgage underwriting standards declined, and automated loan approvals allowed loans to be made without appropriate review and documentation. *Id.* U.S. housing prices peaked and began declining in mid-2006, and then unraveled in late 2006, when many homeowners began to default on their exotic loans. ¶74. The defaults had a cascading effect due to the correlation between rising rates of default on non-prime and non-traditional loans and the falling values of homes, as well as the decline in the value of securities backed by those mortgages. *Id.*

[3] The Complaint includes a detailed description of the residential mortgage market, distinctions between prime and non-prime borrowers, and MBS. *See* ¶¶342-50.

C. Freddie Gorges on Risky Mortgage Loans and Related Assets

Syron was hired in 2004 to "strengthen" Freddie following an accounting scandal at the Company. ¶77. At the time he was hired and into 2005, Defendants found Freddie losing market share to more aggressive private lenders who were originating risky, exotic mortgages to borrowers with below prime credit. ¶80. Looking for an opportunity to grow, and armed with the capability to quickly gain market share in the non-prime and non-traditional mortgage market by out-pricing the competition, Defendants agreed to substantially expand the Company's non-prime and non-traditional loan portfolio. ¶¶81-82. Contrary to the low-risk picture they misleadingly created for the market, Defendants immersed Freddie in dangerous loans as it engaged in a market share war with Fannie Mae ("Fannie") and other Wall Street firms. ¶¶105-06.

At the time Freddie entered the non-prime and non-traditional mortgage market, Defendants received internal warnings (as early as 2004) that Freddie's shoddy underwriting standards, virtually non-existent risk management procedures and resulting purchase of junk mortgages and MBS left it exposed to catastrophic losses. ¶¶81-93. As revealed in internal Freddie emails, throughout 2004, Freddie's Chief Risk Officer, David Andrukonis ("Andrukonis"), expressly warned Syron and others to quickly stop Freddie's purchases of non-traditional loans, calling them "dangerous." ¶¶83-87. For his sounding of the alarm, Andrukonis was fired. ¶88.

Despite these stern warnings, Defendants steamrolled Freddie into the non-prime and non-traditional loan market without adequate safeguards, sufficient quality control standards, or accounting and computing systems capable of determining credit risk and categorizing these new types of extremely risky loans. ¶541. In effect, Defendants leveraged the Company's entire financial well-being on toxic loans, exposing unwitting investors to untold credit risks the Company was incapable of evaluating, even though Defendants claimed it could. ¶¶94-125. Indeed, Freddie's purchases of exotic mortgages and MBS simply "exploded" and it became one of the biggest buyers of subprime MBS. ¶¶94-95.

Defendants accomplished their fraud by creating the fiction that the Company purchased only low-risk prime loans. ¶134, 459 ("Freddie is chartered to focus solely on the $9.4 trillion

conventional/conforming residential mortgage markets"). In addition to various accounting tricks, Defendants categorized non-prime loans as "prime," employing a private, internal standard to distinguish between "prime" and "non-prime" loans that, as Defendants knew, differed materially from the standard used by government agencies and generally accepted in the banking industry. ¶¶143-69. These tactics hid from the market the fact that in each of 2005, 2006, and 2007, 50% or more of the Company's single family purchases consisted of non-prime loans, with the result being that Freddie had more than $628 billion in non-prime loans in its mortgage portfolio, and 35% of the Company's entire single-family credit exposure consisted of such high-risk loans. ¶¶164-69.

D. Throughout the Class Period, Freddie Was Inadequately Capitalized

On top of engaging in "creative" hiding of the Company's non-prime and non-traditional loan exposure, Freddie "engaged in creative accounting making it appear [it] had capital that just did not exist." ¶84. Moreover, Defendants received internal and external warnings during the Class Period that Freddie had dire capital deficiencies and needed to take immediate action. ¶221. For example, following internal "risk scenario meetings" in August 2007, Freddie executives created a risk scenario report, consisting of various risk triggers, that was signed off on by the Individual Defendants. ¶¶222-23 (the "Individual Defendants 'owned' the risk"). This internal report accurately predicted the severity and implications to Freddie of the subprime crash, including loan defaults and the devaluation of MBS, but Freddie never put the necessary systems in place to address the identified risks that materialized. ¶¶226-29. Similarly, Syron also received direct warnings about Freddie's capital inadequacy from Company insiders as well as government officials, who threatened to publicly chastise Freddie if it did not raise capital to bolster its balance sheet. ¶235.

At the same time, Defendants minimized and delayed the Company's financial reporting of its true non-prime and non-traditional loan exposure, concealing existing, massive losses to maintain the mirage of an adequate capital cushion. For example, the Company had a steep increase in defaulting loans in 2007 and 2008. ¶¶243-45. To intentionally delay the timing of write-offs on these non-performing loans, the Company – which normally bought back loans in default after 120 days – switched to only buying them back after they were in default for 360 days. ¶246. This policy

change enabled Freddie to dramatically reduce its apparent capital needs by simply delaying the inevitable, which furthered Defendants' fraud and maintained the artificial inflation of the Company's equity securities. ¶¶246-47.

E. Freddie's False and Misleading Financial Reporting

To hide the true effects of Freddie's immense involvement in the non-prime and non-traditional mortgage market, Defendants committed violations of Generally Accepted Accounting Principles ("GAAP") by failing to record impairments to the Company's mortgage related assets. ¶¶313-440. During the Class Period, many of Freddie's non-prime investments had been in a loss position for at least one year, with losses in excess of $10.5 billion, yet Freddie still accounted for them as if the losses were only a passing trend. ¶352 (Freddie "has not recorded any impairment" on its portfolio of MBS); ¶355 (the value of Freddie's non-prime and non-traditional MBS were in free-fall). At one point during the Class Period, the unrealized losses on Freddie's MBS exploded from $15.1 billion to $32.4 billion – 87% of those losses were attributable to Freddie's subprime and Alt-A backed securities. ¶¶367-68. Despite this massive diminution in value, the fact that many of Freddie's subprime and Alt-A investments had been in a loss position for at least a year, and the fact that it was not at all probable that the Company's investments in non-prime, non-traditional MBS would recover, the Company took no impairments. ¶¶369-93.

In addition, nearly 50% of the Company's core capital was attributable to the Company's deferred tax asset, and Defendants failed to record both a valuation allowance and concomitant charge against earnings. ¶¶429-35. To take advantage of the deferred tax asset, Freddie's management would have needed to forecast more profits than Freddie had reported during its prior five years combined. ¶436. Because management expected just the opposite, Defendants had no reasonable basis for concluding it was "more likely than not" that some portion or all of the tax deferred benefits would be realized, and impairments absolutely should have been recognized during the Class Period. ¶¶436-40. Defendants' egregious failure to record such impairments had the cause and effect of overstating the Company's capital adequacy at all relevant times. ¶¶429-40.

F. The Truth is Revealed Through a Series of Partial Disclosures

The impact of Freddie's massive losses on its mortgage holdings and failure to maintain an adequate capital base was beyond dire. When the truth about the Company's finances and future business prospects were revealed through a series of partial disclosures, market expectations were corrected and the purchasers of Freddie's equity securities suffered billions of dollars in losses.

Towards the end of the Class Period, conflicting information began reaching the market. On one hand, investigative reports openly questioned Freddie's capital adequacy, solvency, and ability to raise more capital. ¶523 (between July 3 and July 10, 2008, a series of articles and analyst reports questioned whether Freddie could raise the $5.5 billion in new capital the Company outlined in May 2008, whether the Company had adequate capital, and whether the Company was even solvent). Further, analysts and market commentators asked whether the government would be required to bail Freddie out, and the government prepared a "rescue" plan for Freddie. ¶529 (U.S. Treasury press release described rescue plan); ¶531 (July 14, 2008 articles discussing U.S. plan to save Freddie); ¶533 (July 15, 2008 news concerning Freddie's financial condition and possible government bailout).

On the other hand, Defendants consistently and adamantly stated to the market that Freddie was solvent, had adequate capital, and could raise more capital at any time, if needed. ¶525 (Freddie "absolutely" had enough capital); ¶526 (July 11, 2008 press release touting Freddie's capital and claiming media speculation did "not accurately reflect the truth"); ¶530 (Company counters U.S. Treasury press release). The result was that, even as negative news about the Company was released, Defendants countered with positive (but false) statements that served to maintain the artificial inflation of Freddie's equity securities. ¶¶525-27, ¶534 (a Freddie Vice President claimed there was a "huge disconnect in the market," that Freddie was "well capitalized," and that "***based on internal information, [Freddie] will continue to have adequate capital***.").

For example, on August 5, 2008, the *New York Times* published an article detailing how Syron rejected clear warnings regarding the Company's extensive purchases of non-prime loans and the impact such purchases had on Freddie's financial health. ¶538. Defendants immediately

responded with a press release expressing outrage at the *New York Times* for reporting such information. ¶538. The next day, on August 6, 2008, while the market began to learn that Freddie was not the low-risk operation it claimed to be and was suffering tremendous losses from non-prime, Defendants continued to tout the Company's capital adequacy. ¶¶542-551 ("We believe we can manage to maintain our capital position for some time.").

On August 16, 2008, *Barron's* published an article stating Freddie was insolvent and significantly overstated the value of its assets. ¶555. The article also openly questioned Freddie's capital adequacy, pointing to Freddie's stockpile of worthless deferred tax assets and delay tactics to avoid recognizing polarizing losses of non-prime mortgages and related MBS. *Id*. The quick decline of Freddie continued, when on August 20, 2008, *Bloomberg* published an article revealing Freddie officials were meeting with the U.S. Treasury, and on August 22, 2008, Moody's downgraded Freddie's preferred stock to just one notch above junk status. ¶¶558-560.

On September 6, 2008, less than two months after asserting it was adequately capitalized and that media reports to the contrary were false, *MarketWatch* revealed the Treasury Department was expected to announce the largest government rescue in U.S. history by taking over Freddie. ¶563. Indeed, the Company fell into such feeble condition that FHFA assumed control over Freddie and placed it into conservatorship on September 7, 2008, bailing it out with approximately $14 billion in taxpayer-financed money. ¶564. By this time, Freddie's common stock was nearly worthless, trading at $0.88 per share on September 8, 2008, while the price of Freddie's preferred shares fell as much as 87%. Clearly, the realities of Freddie's financial condition and future business prospects finally overcame Defendants' wall of misinformation and false and misleading statements – all the lies were exposed.

III. ARGUMENT

A. Legal Standards

1. Rule 12(b)(6) Standards

"In considering a motion to dismiss pursuant to Rule 12(b)(6), the Court construes the complaint liberally, accepting all factual allegations in the complaint as true, and drawing all reasonable inferences in the plaintiff's favor." *In re Tower Auto. Sec. Litig.*, 483 F. Supp. 2d 327, 334 (S.D.N.Y. 2007).[4] "The Court's function on a motion to dismiss is not to weigh the evidence that might be presented at trial but merely to determine whether the complaint itself is legally sufficient." *In re Loral Space & Commc'ns Ltd. Sec. Litig.*, 2004 U.S. Dist. LEXIS 3059, at *5 (S.D.N.Y. Feb. 27, 2004). "The Court should not dismiss the complaint if the plaintiff has stated enough facts to state a claim to relief that is plausible on its face." *Katz v. Image Innovations Holdings, Inc.*, 542 F. Supp. 2d 269, 271 (S.D.N.Y. 2008).

On a motion to dismiss a federal securities fraud action, in addition to the well-settled Rule 12(b)(6) standards, the Court must also consider the heightened pleading standards of the PSLRA and Rule 9(b), as discussed below. *Katz,* 542 F. Supp. 2d at 272. Unfortunately, as a result of these heightened pleading requirements, "motions to dismiss in securities fraud cases have become all too common where the procedural posture of the case renders most of the defendants' arguments futile. Many motions to dismiss ask the court to engage in judgment calls which are better made by the trier of fact." *In re Indep. Energy Holdings PLC Sec. Litig.*, 154 F. Supp. 2d 741, 747 (S.D.N.Y. 2001). Indeed, "[e]ven with the heightened pleading standard under Rule 9(b) and the Securities Reform Act, [the Second Circuit] do[es] not require the pleading of detailed evidentiary matter in securities litigation." *In re Scholastic Corp. Sec. Litig.*, 252 F.3d 63, 72 (2d Cir. 2001).

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[4] Citations and footnotes are omitted, and emphasis is added, unless otherwise noted.

2. The Bulk of Defendants' Exhibits Should Be Ignored

While "detailed evidentiary matter" is not required, a court on a Rule 12(b)(6) motion may consider "documents incorporated into the complaint by reference, and matters of which a court may take judicial notice." *Tellabs, Inc. v. Makor Issues & Rights, Ltd.*, 551 U.S. 308, 322 (2007) ("*Tellabs*"). This statement of the law is well settled and unremarkable. Yet, by submitting numerous extraneous exhibits for the sole purpose of rebutting the factual allegations of the Complaint, Defendants turn Rule 12(b)(6) on its head.

For example, Defendants offer: (a) 22 documents, largely news articles, containing analyses regarding the causes, scope, duration and future of the downturn in the U.S. economy, as well as its purported impact on particular industries and companies (Def. Exh. 1, 43, 48, 50-54, 56, 58-59, 62, 65-67, 69-73, 76, 78); and (b) 11 documents purportedly refuting specific factual allegations in the Complaint concerning issues such as the impact of certain Congressional testimony concerning Freddie's demise (Def. Exh. 41, 45, 46, 47, 49, 57, 61, 64, 68, 74, 77). These documents are not properly before the Court on a motion to dismiss, and should be stricken or otherwise disregarded.[5]

First, those documents offering commentary on the state of the economy or on the motivations of individuals offering testimony are, at most, expressions of opinion – not indisputable facts – and, thus, are not amenable to judicial notice. *See In re StockerYale Sec. Litig.*, 453 F. Supp. 2d 345, 348 (D.N.H. 2006) ("Nor are the editorial comments and analysis contained in the [market] commentary about overall trends in the security sector the kind of information that is subject to judicial notice."); *see also In re Wash. Mut., Inc., Sec. Litig.*, 259 F.R.D. 490, 495 (W.D. Wash. 2009) (declining to take judicial notice of administrative reports and newspaper articles pertaining to the economic downturn and deterioration of the housing market because "these documents are not

[5] In a blatant attempt to skirt the Court's September 2, 2009 Order denying its motion to submit a 100 page brief, Freddie has simply excised 18 pages of legal argument from its prior brief and attached it as an "exhibit" to the current motion. *See* Def. Exh. 44. This is patently improper.

necessary to decide the issues presented in these motions . . . "); *Atlas v. Accredited House Lenders Holding Co.*, 556 F. Supp. 2d 1142, 1161 n.7 (S.D. Cal. 2008) (same).[6]

Second, to the extent that certain materials are subject to judicial notice, Defendants improperly attempt to use such extraneous information to resolve disputed factual issues in their favor. In so doing, Defendants ignore that, on a motion to dismiss, the presumption of truth applies to Plaintiffs' allegations, not to Defendants' exhibits. *In re Direct Gen. Corp. Sec. Litig.*, 398 F. Supp. 2d 888, 894 (M.D. Tenn. 2005) ("It would be improper for the Court to rely upon this [SEC filing] to determine disputed factual issues."); *In re Immune Response Sec. Litig.*, 375 F. Supp. 2d 983, 995 (S.D. Cal. 2005) (judicial notice improper where "Defendants offer the documents as evidence that Defendants did not commit securities violation[s].").[7] Thus, while the Court can take judicial notice of the fact that the U.S. economy was in a downturn during the Class Period (a fact which Plaintiffs acknowledge), it may not, at the motion to dismiss stage, draw inferences from that fact to refute the factual allegations in the Complaint. *In re 2007 Novastar Fin., Sec. Litig.*, 2008 WL 2354367, at *1 (W.D. Mo. June 4, 2008), *aff'd*, 579 F.3d 878 (8th Cir. 2009) ("[J]ust as the Court could take judicial notice of the fact that the country suffered from the Great Depression in the 1930s, the Court cannot use that fact to infer anything in particular about a business operating at the time."); *Beaver County Ret. Bd. v. LCA-Vision Inc.*, 2009 WL 806714, at *8 (S.D. Ohio Mar. 25, 2009) ("The Court cannot conclude that these articles, albeit relevant to Plaintiff's claims, are integral to the Complaint. Further, to the extent the articles refer to independently verifiable data, such as consumer confidence levels, they are redundant because the Court has already taken judicial

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[6] *See, e.g.*, Def. Exh. 45 (journal article describing a Congressional hearing on Fannie as a "***highly charged political showdown***" that "***had a decidedly partisan edge…***").

[7] *See, e.g.*, Def. Mem. at 8 (citing to Def. Exh. 47, Freddie contends: "As HUD specifically acknowledged, Freddie Mac has 'been prudent in [its] pursuit of subprime lending, focusing on the top part of the market.'"); Def. Mem. at 11 (citing to Def. Exh. 49, Freddie contends: "As late as mid-July 2008, market watchers did not believe that the danger to financial institutions would approach the levels seen in the banking crisis of the late 1980s and early 1990s, let alone in the Great Depression.").

notice of the consumer confidence and other economic indicator indexes for the relevant time period.").

3. Defendants' "Defective Pleading" Argument is a Red Herring

To further distract the Court from the substance of the fraud allegations, Defendants attack the structure of the Complaint, asserting that Plaintiffs have pled their allegations in a "scattered" format designed to "confuse and obscure." Def. Mem. at 23-24. But Plaintiffs do not seek to impose on the Court or Defendants "the burden of divining which specific statements are allegedly false and the matching them up with allegations of wrongdoing…" *Id.* at 24. Rather, the Complaint, while admittedly lengthy due to the nature of the fraud and the success of Plaintiffs' investigation, is structurally sound and easy to understand. For ease of reference, it logically divides the allegations into identifiable sections with clear, concise headings and subheadings, identified up front in a table of contents. Thus, Defendants' objections to the form of the Complaint are not well taken. *In re Countrywide Fin. Corp. Sec. Litig.*, 588 F. Supp. 2d 1132, 1156-57 (C.D. Cal. 2008) ("[G]iven the extraordinary complexity of this case's factual allegations, the lengthy class period, and the wide swath of defendants, focusing on the CAC's rhetorical and structural flaws would be a pointless enterprise.").

Defendants are also wrong to suggest that Plaintiffs' pleading style serves to mask a lack of particularity under the PSLRA. Def. Mem. at 23-25. In complex cases such as this involving multiple misrepresentations, courts routinely reject arguments that a pleading is too lengthy or complex on one hand, but lacks specificity or particularity on the other:

> [A] long and detailed complaint is not a work of 'puzzle pleading' as a matter of law. Furthermore, in the securities class action context, the stringent pleading requirements appear to invite both parties to throw everything and the kitchen sink into their respective pleadings and motions to dismiss. The plaintiff creates an inevitably detailed complaint in anticipation of defendants' rigorous 12(b)(6) motions, and the plaintiff's expectations are confirmed when defendants in due course file those motions.
>
> The plaintiff has the responsibility to craft a clear and concise complaint, but the allegations that discharge this responsibility will depend on the type of action, the specific facts, the number of parties, and other variables. Here, Plaintiffs' Complaint

> provides adequate organization and sufficiently clear allegations such that this Court is able to rule on Defendants' motions, and Defendants have adequate notice of the allegations against them. Is the pleading still long? Yes. Is it still extremely detailed and complex? Yes. Is this by itself a reason to dismiss the complaint? No.

In re New Century, 588 F. Supp. 2d 1206, 1219 (C.D. Cal. 2008); *In re Honeywell Int'l Sec. Litig.*, 182 F. Supp. 2d 414, 416 (D.N.J. 2002) ("Defendants challenge the Complaint, claiming that rather than being a 'short and plain statement of the claim' in conformity with [Rule] 8 it is [a] 'puzzle pleading' that fails to meet the requirements of Rule 9(b) and the [PSLRA]. The Complaint certainly is not short, but if it is a puzzle, it is meant for a child and can be assembled readily."). These criticisms of so-called puzzle-pleading arguments are particularly appropriate here – where Defendants clearly understood the nature of Plaintiffs' claims as evidenced by their coherent and lengthy motions. *See Roublow v. Principi*, 2005 WL 757356, at *2 (E.D. La. Mar. 30, 2005) ("while Plaintiff's complaint may contain some needless language, defense counsel was able to identify the nature of Plaintiff's complaint and her claims. Thus, the complaint has caused no confusion to Defendant regarding the nature of the complaint and what it alleges.").

Adhering to the pleading standards of the PSLRA and Rule 9(b), Plaintiffs identify the who, what, when, and where concerning each false and misleading statement – ***specifically highlighting the false statements with bold and italics*** – issued during the Class Period. Then, cross-referencing an extensive factual discussion, including citation to detailed and corroborating sources, Plaintiffs summarize precisely ***why*** those statements are false and misleading. While Defendants obviously do not like these facts, they cannot seriously contend that the Complaint "fails to identify what specific statements . . . are supposedly false, let alone why." Def. Mem. at 24; *compare In re Tyco Int'l, Ltd. Multidistrict Litig.*, 2004 U.S. Dist. LEXIS 20733, at *30 (D.N.H. Oct. 14, 2004) ("After identifying each specific misleading statement, the complaint refers readers to other sections that list multiple

reasons why the statement is misleading. This is a reasonable way to address a complicated securities fraud case.”).[8]

4. Defendants’ Attacks on Plaintiffs’ Counsel are Disingenuous

Accusing Plaintiffs’ counsel of pushing “a lawyer-driven strike suit,” Defendants feign outrage at the fact that Plaintiffs’ counsel, a prominent and successful securities class action firm, has been involved, in varying capacities, in multiple lawsuits regarding fraudulent conduct at the Company over the past several years. Def. Mem. at 3-4; I.D. Mem. at 2. Aside from its inflammatory accusations, Defendants are dead wrong on the facts:

- Although Plaintiffs’ counsel filed and voluntarily dismissed the prior *Reimer* action, it ***did not*** “file[] this belated action,” as Defendants boldly state. Def. Mem. at 3-4. Other firms filed the existing *Kuriakose* action with another named plaintiff, with no involvement from Plaintiffs’ counsel.

- Along with numerous other investors, Plaintiff Central States timely moved for lead plaintiff status pursuant to the requirements of the PSLRA. After a contentious battle, Central States was appointed as lead plaintiff and its selection of counsel was approved. Consequently, Plaintiffs’ counsel involvement in this case is, by no means, “transparent.” Def. Mem. at 4.

- Despite some factual similarities, the *Kuriakose* action is markedly different from the *Reimer* action. While the *Reimer* action involves fraudulent conduct related to statements preceding Freddie’s November 20, 2007 announcement of a $2 billion loss, the *Kuriakose* action involves ***subsequent*** misrepresentations describing how continuing, massive losses attributable to concealed non-prime loan purchases presented an “opportunity” for the Company and posed no threat to the Company’s capital adequacy.

- While, ***at the time of the filing*** of the *Reimer* action in November 2007, Plaintiffs’ counsel (and many others) believed that Defendants were finally candid with the market, ***subsequent developments***, culminating in Freddie’s conservatorship in September 2008, have clearly demonstrated that Defendants were less than forthcoming. Because Plaintiffs and their counsel in the *Kuriakose* action represent a different class based on different misrepresentations, it should come as no surprise

[8] Defendants’ attempt to analogize the Complaint in this case to the pleading in *2007 Novastar Fin.*, 579 F.3d 878, is flawed. The Complaint here does exactly what the Complaint in *Novastar* purportedly did not do – it specifically alleges the false and misleading statements made by Defendants and specifies in detail the reasons why those statements were false and misleading. *See, e.g.*, ¶¶441-452.

> that "Coughlin Stoia does not in this case represent a single shareholder who purchased Freddie Mac stock before November 20, 2007." Def. Mem. at 4.

Accordingly, Defendants' attempt to impugn Plaintiffs' counsel is nothing more than a distracting sideshow. It serves no legitimate purpose, and does not advance the disposition of this action in any meaningful way. All it does is highlight the lengths to which Defendants will go to obfuscate the massive fraud they perpetrated.

B. Plaintiffs State a Claim for Violations of §10(b)

Under §10(b) of the Exchange Act and Rule 10b-5 promulgated thereunder, it is unlawful for any person, directly or indirectly, to commit fraud in connection with the purchase or sale of securities. 15 U.S.C. §78j(b); 17 C.F.R. §240.10b-5. "To state a claim under Section 10(b) and Rule 10b-5 a plaintiff must plead that the defendant (1) made misstatements or omissions of material fact; (2) with scienter; (3) in connection with the purchase or sale of securities; (4) upon which plaintiff relied; and (5) that plaintiff's reliance was the proximate cause of the injury." *In re Van Der Moolen Holding N.V. Sec. Litig.*, 405 F. Supp. 2d 388, 398 (S.D.N.Y. 2005).

Like most securities fraud defendants, Defendants throw the "kitchen sink" at the Complaint, seemingly raising every conceivable argument in support of its dismissal. Such overreaching is hardly surprising. As discussed below, however, the Complaint sufficiently pleads the requisite elements of loss causation, material misrepresentations, and scienter in accordance with the applicable pleading standards. Accordingly, the motions to dismiss should be denied.

1. The Complaint Adequately Pleads Loss Causation

A plaintiff bringing a §10(b) claim must allege loss causation, which is a "causal connection between the material misrepresentation and the loss." *Dura Pharms., Inc. v. Broudo*, 544 U.S. 336, 341 (2005) ("*Dura*"). This requires a plaintiff to do nothing more than "provide a defendant with some indication of the loss and the causal connection that the plaintiff has in mind." *Id*. at 347. Importantly, the Supreme Court rejected any heightened pleading standard for loss causation, affirming that the "ordinary pleading rules" of Rule 8(a)(2) provide a "simple test" that should not "impose a great burden upon a plaintiff." *Id*. at 346-47. Courts within this Circuit have expressly

recognized that *Dura* did not alter or otherwise modify existing Second Circuit standards for pleading loss causation. *See, e.g.*, *In re Initial Pub. Offering Sec. Litig.*, 399 F. Supp. 2d 298, 301 (S.D.N.Y. 2005) ("*Dura* did not disturb Second Circuit precedent regarding loss causation.").

In challenging Plaintiffs' loss causation allegations, Defendants contend that: (1) Plaintiffs' loss causation allegations are governed by Rule 9(b); (2) Plaintiffs' losses were caused by a "marketwide phenomena," not any fraud committed by Defendants; (3) Plaintiffs fail to allege an identifiable corrective disclosure; and (4) Freddie's stock price increases show that Plaintiffs did not suffer an economic loss. Def. Mem. at 14-22. These arguments are meritless. As set forth below, excluding Defendants' factual disputes, the Complaint sufficiently pleads loss causation through a series of partial disclosures providing Defendants with "fair notice" of Plaintiffs' theory of loss through a "short and plain statement of the claim showing that the pleader is entitled to relief." *Dura*, 544 U.S. at 337; *In re Bristol Myers Squibb Sec. Litig.*, 586 F. Supp. 2d 148, 163 (S.D.N.Y. 2008).

a. Defendants Distort the Applicable Pleading Standards

Although virtually every court has recognized – consistent with the U.S. Supreme Court's decision in *Dura* – that loss causation allegations should be evaluated under Rule 8, Defendants halfheartedly assert that "Plaintiff must allege loss causation with particularity under Rule 9(b)." Def. Mem. at 15; *compare In re Tower Auto.*, 483 F. Supp. 2d at 348 ("[N]early all courts addressing the [the pleading of loss causation] since [*Dura*] have also applied Rule 8, rather than the heightened pleading standard of Rule 9."). Indeed, in the very next sentence, Defendants effectively concede that "the less rigorous standard of Rule 8" applies to allegations of loss causation. Def. Mem. at 15. Even so, relying on the U.S. Supreme Court's decision in *Ashcroft v. Iqbal*, 129 S. Ct. 1937, 1950 (2009), Defendants posit an overly expansive dismissal standard that distorts well-settled Rule 12(b)(6) jurisprudence. Def. Mem. at 15.

To be sure, Defendants contend that, under *Iqbal*, "a complaint should be dismissed where the plaintiff's allegations fail to exclude 'more likely explanations' than those alleged in the complaint" *Id*. This, quite frankly, goes too far. As the Supreme Court articulated in *Iqbal*, "[t]o

survive a motion to dismiss, a complaint must still contain sufficient factual matter, ***accepted as true***, to state a claim to relief that is plausible on its face. Facial plausibility is established when a plaintiff pleads factual content that allows the court to draw the ***reasonable inference*** that the defendant is liable for the misconduct alleged." *Green v. Beer*, 2009 U.S. Dist. LEXIS 98285, at *7-8 (S.D.N.Y. Oct. 22, 2009) (emphasis in original). In making this determination, however, "the court is not to weigh the defendant's and plaintiff's stories to determine which one is 'more plausible.'" *Riley v. Vilsack*, 2009 U.S. Dist. LEXIS 98548, at *30 (W.D. Wis. Oct. 22, 2009). "That level of scrutiny is inappropriate even at the summary judgment stage." *Id.*

In fact, Defendants' contention – that Plaintiffs must affirmatively exclude the "more likely explanation" that a "marketwide phenomena" was an "intervening cause" of investor losses (Def. Mem. at 15-17) – is based on a complete misreading of *Dura*. In short, Defendants confuse what Plaintiffs must ***plead*** with what Plaintiffs must ***prove*** on the issue of loss causation. *Ong v. Sears, Roebuck & Co.*, 2006 U.S. Dist. LEXIS 73801, at *56 (N.D. Ill. Sept. 27, 2006) ("The court declines to read into this language [in *Dura*] a holding that a plaintiff can only allege causation by ruling out all other factors that may have contributed to a security's lower resale price . . . . The Court's discussion of the potential for other factors contributing to a declining share price provides a rationale for requiring a plaintiff to tie that decline to a defendant's wrongful conduct."). The "chicken or the egg" type of analysis proffered by Defendants is simply inappropriate at the motion to dismiss stage. *See, e.g.*, *Silverman v. Motorola, Inc.*, 2008 WL 4360648, at *15 (N.D. Ill. Sept. 23, 2008) ("There is no requirement at the pleading stage that a plaintiff 'affirmatively rule out those other factors in its complaint; rather that burden arises at trial'"); *In re IMAX Sec. Litig.*, 587 F. Supp. 2d 471, 486 (S.D.N.Y. 2008) ("[D]efendants will be entitled to interpose their defense of intervening facts . . . at trial").

b. Defendants Cannot Hide Behind the Market Collapse They Played a Substantial Role in Creating and Perpetrating

As noted, the crux of Defendants' loss causation defense is to blame the drop in the price of Freddie's securities on a "marketwide phenomena" caused by "deteriorations of the mortgage and

credit markets." Def. Mem. at 16-17. This argument, however, conveniently ignores Freddie's indisputable role in causing the economic crisis, as extensively detailed in the Complaint. *Stumpf v. Garvey*, 2005 WL 2127674, at *12 (D.N.H. Sept. 2, 2005) ("Here, the collapse of the market . . . was arguably not an intervening event, but rather the proximate result of the defendants' misrepresentation of the demand [for the company's product]."). In fact, the Complaint clearly alleges that, by gorging on billions of dollars worth of very risky loans, Freddie threatened the stability of the very residential mortgage market that it was created to protect. ¶¶64, 94-125.

Even if the Court overlooks Freddie's material contributions to the deteriorated economic environment, this Court need not blindly accept Defendants' efforts to blame Freddie's problems on that environment:

> It is not the Court's role to speculate on the causes of the current economic situation. However, it is the Court's task to manage this litigation efficiently and avoid wasteful arguments. For the past year, almost all Defendants have recited -- at hearings and in their papers -- that an 'unprecedented' external 'liquidity crisis' caused all (or most) of Countrywide's decline. . . .
>
> It is true, the dramatic market shifts will raise complicated questions on damages. It will be the fact-finder's job to determine which losses were proximately caused by Countrywide's misrepresentations and which are due to extrinsic or insufficiently linked forces.
>
> The Court will not be distracted by liquidity versus solvency and other macroeconomic arguments. The CAC's allegations invite the cogent and compelling inference that Countrywide's deteriorating lending standards were causally linked to at least some of the macroeconomic shifts of the past year. The CAC alleges that reasonable people may differ about how much of situation is attributable to Countrywide and its industry. For example, it quotes Treasury Secretary Paulson as having said, '[T]his turbulence wasn't precipitated by problems in the real economy. This came about as a result of some bad lending practices.'
>
> The issue at present is whether the alleged securities violations caused a loss. Not how much of the loss the alleged violations proximately caused.

Countrywide, 588 F. Supp. 2d at 1173-74.[9] Given the Company's unique role in the residential mortgage market, this reasoning applies here with even greater force.

In any event, Defendants' fact-based arguments would be somewhat believable (although still premature) but for the problem that they are plainly incorrect. For example, contrary to Defendants' insistence that Freddie's losses were the result of the "collapse of the residential mortgage market," Syron consistently maintained during the Class Period that ***"[i]t is essential to note that a significant portion of our losses were not economic, but the result of accounting conventions."*** ¶¶459, 474, 489. Moreover, while, as Plaintiffs expressly acknowledge, the economic crisis existed prior to, and throughout, the Class Period, Defendants repeatedly informed investors that Freddie took "important steps to address the impact" of the crisis that would lead to significant "opportunities" when the crisis ended. *See* ¶441. These (and other) false statements included in the Complaint completely undercut Defendants' ability to pass the blame for its misconduct on external economic circumstances.

c. Plaintiffs Provided "Fair Notice" of Their Theory of Loss Causation

Defendants next claim that "Plaintiff[s] fails sufficiently to plead that any fraud actually caused any losses" because the "supposedly corrective disclosures" did not "reveal[] any supposed fraud." Def. Mem. at 18-19. But Defendants' interpretation of *Dura* is much too "rigid and dogmatic." *See, e.g., In re Bradley Pharms., Inc. Sec. Litig.*, 421 F. Supp. 2d 822, 828 (D.N.J. 2006).

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[9] By contrast, the cases relied upon by Defendants are unavailing and overstated because those decisions were premised on prior findings that the defendants did not commit fraud. In *In re Downey Sec. Litig.*, 2009 WL 2767670, at *1, *15 (C.D. Ca. Aug. 21, 2009), the court did not hold that "the current economic climate" was the cause of the stock price decline. Instead, because it already determined that "the public disclosures referenced in the FACC do not contain a disclosure of wrongdoing," the court concluded that the only plausible explanation for the stock price decline was the market's reaction to news of "Downey's poor financial health." *Id*. at *15. Similarly, in *In re First Marblehead Corp. Sec. Litig.*, 639 F. Supp. 2d 145, 164-65 (D. Mass. 2009), the court found that, because "First Marblehead provided adequate disclosures," which "negate[d] any theory that there was a concealed fraud or risk to be disclosed to the market," the stock price drop was explained by "a significant downturn in the credit markets" and "First Marblehead's preexisting pattern of stock declines."

Indeed, contrary to Defendants' suggestions, *Dura* does not require that a defendant issue a ***corrective*** disclosure, let alone issue one expressly and fully revealing every aspect of the alleged fraudulent scheme at a single time. *See, e.g.*, *In re Motorola Sec. Litig.*, 505 F. Supp. 2d 501, 544 (N.D. Ill. 2007) ("This court does not read *Dura* to imply that a plaintiff cannot satisfy loss causation without identifying a corresponding, mirror-image prior representation for every disclosure that precedes a share price decline."); *In re Parmalat Sec. Litig.*, 376 F. Supp. 2d 472, 510 (S.D.N.Y. 2005) ("[L]oss causation does not, as the defendants would have it, require a corrective disclosure followed by a decline in price.").

In fact, *Dura* focuses the inquiry on the disclosure of the "truth," *i.e.*, the revelation to the market of the true state of the Company's finances or operations, previously hidden by fraud, thereby eliminating inflation in the price of the stock. *Dura*, 544 U.S. at 342-43; *In re Winstar Commc'ns*, 2006 WL 473885, at *14-15 (S.D.N.Y. Feb. 27, 2006) ("The Supreme Court spoke in terms of the 'relevant truth' and the 'truth' making its way into the market place."). Thus, courts applying *Dura* have repeatedly held there is no requirement that a complaint allege a specific, direct or "mirror image" disclosure or admission that prior statements were false. *See, e.g.*, *In re Williams Sec. Litig.-WCG Subclass*, 558 F.3d 1130, 1140 (10th Cir. 2009) ("To be corrective, the disclosure need not precisely mirror the earlier misrepresentation, but it must at least relate back to the misrepresentation and not to some other negative information about the company."); *In re Take-Two Interactive Sec. Litig.*, 551 F. Supp. 2d 247, 285 (S.D.N.Y. 2008) ("To be sure, a plaintiff may plead loss causation without alleging a disclosure that precisely mirrors the substance of a prior undisclosed fraud.").[10]

Defendants' insistence that loss causation was not properly pled because no "concealed facts became known" is simply wrong. Def. Mem. at 15. In this regard, in compliance with *Dura*, the

[10] The reason for this rule is simple: "if [courts] are too exacting in [their] demands for a connection between the initial misrepresentation and subsequent revelation – for instance, by imposing a mirror image requirement . . . then we would eliminate the possibility of 10b-5 claims altogether." *In re Williams*, 558 F.3d at 1140; *Motorola*, 505 F. Supp. 2d at 544 ("Defendants' proposed rule would provide an expedient mechanism for wrongdoers to avoid securities fraud liability.").

Complaint alleges a series of partial disclosures, spanning from July through September 2008, which indicated how the truth about the Company's non-prime and non-traditional loan exposure and capital inadequacy became "generally known" and corrected market expectations. These disclosures include:

- July 3-10, 2008 news and analyst reports discussing the difficulties encountered by Freddie in raising capital and its anticipated need to raise additional capital going forward to avoid insolvency and a government bailout. ¶523.

- July 13-15, 2008 press releases, news reports and other information detailing the government's plan to rescue Freddie and Fannie with an infusion of capital. ¶¶529, 531, 533.

- an August 5, 2008 *New York Times* article describing, *inter alia*, (a) Syron's refusal to heed warnings about the risks of engaging in non-prime loan purchases and the need to maintain an adequate capital cushion, and (b) the resulting increase in purchases of bad loans and decrease in the Company's available capital. ¶538.

- an August 6, 2008 press release, SEC filing and analyst conference call revealing that Freddie incurred massive losses due to its investments in non-prime loans. ¶¶542-51.

- an August 16, 2008 *Barron's* article describing, *inter alia*, that the government may need to takeover Freddie and Fannie due to considerable (and continuing) losses arising from non-prime loans and grossly overstated capital levels. ¶555.

- a September 7, 2008 *New York Times* article indicating that the government took control of Freddie and Fannie, removed their top executives and boards, and placed them into a conservatorship. ¶¶563-64.

More than disclosing mere "bad news" or information that was "already publicly available," these partial disclosures revealed, chronologically over a period of three months, a series of increasingly disturbing reports that are ***directly related*** to Plaintiffs' allegations concerning the nature and extent of Freddie's non-prime and non-traditional loan exposure and its dire capital position. *Lormand v. US Unwired, Inc.*, 565 F.3d 228, 261 (5th Cir. 2009) ("[L]oss causation may be pleaded on the theory that the truth gradually emerged through a series of partial disclosures and that an entire series of partial disclosures caused the stock price deflation."). It does not matter that Defendants did not admit any fraud; the issue is whether the market viewed these public revelations as "corrective" events, which signaled that the Company's prior representations were not entirely

true or accurate. *In re eSpeed, Inc. Sec. Litig.*, 457 F. Supp. 2d 266, 297 (S.D.N.Y. 2006) ("Drawing all reasonable inferences in plaintiffs' favor at this stage of the proceedings, the *CBS Marketwatch* article could establish that, despite Lutnick's specific denial, the market understood by the end of the putative class period what it did not before -- that the 'new fees' or 'new charges' entailed by PI were damaging eSpeed's market share and financial performance."); *see also In re Worldcom, Inc. Sec. Litig.*, 2005 WL 2319118, at *23 (S.D.N.Y. Sept. 21, 2005) (to satisfy loss causation under *Dura*, plaintiff must "establish that his losses were attributable to ***some form of revelation*** to the market of the wrongfully concealed information").[11]

In sum, Plaintiffs' loss causations allegations amply satisfy *Dura*'s "simple test." The Complaint alleges adverse news leaked out into the market – tempered, in large part, by Defendants' positive spin (¶¶525-26, 530, 537, 539, 554, 558) – concerning tremendous losses attributable to undisclosed investments in risky non-prime and non-traditional loans that negatively impacted the Company's capital position. ¶¶523, 529, 531, 533, 538, 542, 551, 555, 563-64. It describes how numerous market participants reacted adversely to these progressively worsening disclosures, and it details the effect of these disclosures on the price of Freddie's equity securities. ¶¶523-24, 532-33, 535, 552, 556, 559, 561-62. Despite Defendants' protests and an apparent lack of understanding about the concept of a "partial disclosure," nothing more is required at the pleading stage.[12] ¶¶570-81.

[11] Taking issue with former Treasury Secretary Paulson's press release regarding the federal government's plans to rescue the Company, Defendants contend that it "had no control over the Administration, had never presumed to predict what the Administration would do, and is not alleged to have done so. Accordingly, it cannot have concealed a risk that the Administration would decide to take or not take any actions with respect to Freddie Mac." Def. Mem. at 19. This misses the point. First, it ignores that disclosures of the truth may come from third parties. *Lormand*, 565 F.3d at 264 ("*Dura* does not prevent a plaintiff from alleging or proving loss causation by showing partial or indirect disclosures of such truth by persons other than the defendants."). Second, Plaintiffs allege that the startling disclosure that the federal government had to take extraordinary steps to bolster Freddie's capital position contradicted Defendants' prior statements that Freddie was adequately capitalized.

[12] A "partial disclosure" of the "truth" arises where some truthful information is revealed to the market, but defendants fail to reveal, ignore or otherwise deny the full extent of the problems. *See In re Tommy Hilfiger Sec. Litig.*, 2007 U.S. Dist. LEXIS 55088, at *8 (S.D.N.Y. July 20, 2007) (in concluding that plaintiff pled

d. Plaintiffs Allege Sufficient Stock Price Movement

Using charts and other related data, the Complaint explains how Defendants' misrepresentations during the Class Period artificially inflated the price of Freddie's securities. ¶¶450, 455-56, 464, 468, 470, 484, 488, 497-98, 512-13, 517, 520. Then, as a series of partial disclosures revealed the truth about Freddie's non-prime and non-traditional loan exposure and capital problems, the Complaint further describes how the market reacted negatively to those disclosures. ¶¶523-24, 532-33, 535, 552, 556, 559, 561-62.

Nonetheless, Defendants assert that Plaintiffs have not adequately alleged loss causation because, on some occasions, "a number of allegedly corrective disclosures . . . were followed by stock ***increases***." Def. Mem. at 19 (emphasis in original). At the motion to dismiss stage, however, this is a non-starter. "[A]n ambivalent market response" to allegedly false statements "is not a basis for dismissal" where the plaintiff alleged that "the stock price was, at least on some of the dates and at least in part, affected by" the defendants' misrepresentations. *Swack v. Credit Suisse First Boston*, 383 F. Supp. 2d 223, 241-42 (D. Mass. 2004).

In *Swack*, the defendants challenged loss causation at the pleading stage by arguing that certain misstatements "had little or no discernible effect on the stock price" (*i.e.*, on different occasions, the stock price increased, decreased or remained the same in response to the defendant's public statements), and that, even "when the conflicts were disclosed, no further decline occurred." *Id*. at 239-40. In rejecting this challenge to loss causation based on "the history of stock price movements," the district court noted:

> Stock prices rise and fall for combinations of many different reasons. Defendants' conduct could have tempered a drop in price that would otherwise have occurred, or resulted in a greater increase than the stock would otherwise have enjoyed, absent the deceptive analyst reports. The question for Rule 12(b)(6) purposes is whether Swack must now plead the specific mechanisms by which this occurred, or whether that can

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loss causation, court noted that "the truth here was revealed not in a neat and tidy single disclosure, but occurred through a series of disclosing events.").

> await a later stage of the litigation, when she has had a chance to develop expert testimony.
>
> * * *
>
> Evidence that the stock price changed in particular ways on particular days in a manner apparently inconsistent with a plaintiff's theory is powerful evidence. But it is just that -- evidence. At this stage, my task is to examine the formal sufficiency of the pleadings, not to determine whether there is evidence sufficient to support a jury verdict in plaintiff's favor.

Id. at 240-42.

Post-*Dura* decisions are in accord. In *In re Seitel, Inc. Sec. Litig.*, 447 F. Supp. 2d 693, 711 (S.D. Tex. 2006), a defendant argued that "Plaintiff cannot adequately plead loss causation, because Seitel's stock price increased when it announced the restatement and did not decline in any meaningful way until it announced disappointing revenues for the first quarter of 2002." In rejecting this argument, the district court recognized that "the Supreme Court [in *Dura*] did not adopt the argument that a plaintiff must show that the stock price declined due to a specific corrective disclosure or financial restatement." *Id*.[13]

Here, Freddie's stock price movements throughout the Class Period were invariably caused by many factors. Most notably, the Complaint alleges that, on several occasions, Defendants mitigated drops in the stock price with immediate, positive responses to the revelations of the truth about the Company's operations. *See*, *e.g.*, ¶525 (Freddie spokesperson responds to spate of adverse new articles); ¶530 (Freddie press release responds to government rescue plan); ¶539 (Freddie press release entitled "Freddie Mac Responds to the New York Times"). Consequently, Plaintiffs

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[13] The two cases cited by Defendants are easily distinguished. In *In re Maxim Integrated Prods.*, 639 F. Supp. 2d 1038, 1046 (N.D. Cal. 2009), the court did not rule that a small stock increase on the day following a corrective disclosure negated loss causation. Rather, the court found that, when the stock price eventually declined 8 months later, the requisite causal connection was too temporally attenuated. *Id*. at 1046-47. Similarly, in *In re Buca Inc. Sec. Litig.*, 2006 WL 3030886, at *9 (D. Minn. Oct. 16, 2006), the court, without any elaboration, found that a partial disclosure occurring within a week of when the stock price rose negligibly was insufficient. Here, for the most part, Plaintiffs allege that equity stock prices declined following disclosures that corrected market expectations. And, unlike here, there is no indication in *Buca* that the defendants issued public statements to prop up the stock price following the disclosure of adverse news.

specifically plead that this type of positive "spin" impacted the price of Freddie's securities. *See Steiner v. MedQuist Inc.*, 2006 U.S. Dist. LEXIS 71952, at *67 (D.N.J. Sept. 29, 2006) (holding that where negative disclosures were offset by positive news masking the negative effect on the stock price, loss causation was not defeated); *Goldberg v. Household Bank, F.S.B.*, 890 F.2d 965, 966 (7th Cir. 1989) ("Yet a firm that lies about some assets cannot defeat liability by showing that other parts of its business did better than expected, counterbalancing the loss.").[14]

In any event, "isolating the myriad causal factors that affect stock price is a factual question that should be decided at trial, with the help of qualified experts. It is not an issue appropriate for a motion to dismiss." *In re Credit Suisse-AOL Sec. Litig.*, 465 F. Supp. 2d 34, 55 (D. Mass. 2006); *Schleicher v. Wendt*, 529 F. Supp. 2d 959, 968 (S.D. Ind. 2007) ("At later stages of the case, loss causation is likely to present a very complex problem, as a factual matter. Plaintiffs have alleged fraud with respect to eight major topics in a host of public filings and statements over sixteen months. During those same sixteen months, many other ***disclosed*** factors clearly contributed to the further erosion of Conseco share prices. At the pleading stage of the case, however, plaintiffs have alleged enough in the second amended complaint to survive a motion to dismiss on this basis."); *Motorola*, 505 F. Supp. 2d at 557 ("Lead Plaintiff does not bear the burden, for purposes of this motion, of 'isolating' the causal effect of Telsim news from all other factors that may have contributed to a particular price decline. Nor can Defendants prevail on summary judgment by arguing that the May 15, 2001 price decline was insignificant and that investors thus suffered no

[14] Defendants' comparisons of its stock price movements to those of Fannie provide no cover here. Def. Mem. at 4-5, 22. Much like Freddie, Fannie is accused of the same type of fraudulent conduct, and is subject to a similar type of securities class action with a similar class period. Moreover, as expert testimony will ferret out, Freddie's stock price did not move in tandem with Fannie or any other competitor. In fact, Plaintiffs' expert can easily provide numerous examples where adverse news solely relating to Freddie did not move Fannie's stock price. That argument is clearly for another day and should not factor into the Court's Rule 12(b)(6) calculus.

economic loss . . . . [A] disagreement between experts thus creates a dispute of fact inappropriate for resolution on summary judgment.").[15]

2. The Complaint Alleges Actionable Misstatements

The PSLRA imposes heightened pleading requirements on plaintiffs alleging false and misleading statements. According to the Second Circuit, this means that "[a] securities fraud complaint based on misstatements must (1) specify the statements that the plaintiff contends were fraudulent, (2) identify the speaker, (3) state where and when the statements were made, and (4) explain why the statements were fraudulent." *ATSI Commc'ns, Inc. v. Shaar Fund, Ltd.*, 493 F.3d 87, 99 (2d Cir. 2007). In so doing, "plaintiffs need only plead with particularity ***sufficient facts*** to support those beliefs" that a defendant's statements are false and misleading. *Novak v. Kasaks*, 216 F.3d 300, 313-14 (2d Cir. 2000).

In their respective motions, Defendants clamor that the Complaint fails "to plead a single alleged misrepresentation or omission with the requisite particularity." Def. Mem. at 23; I.D. Mem. at 7. To the contrary, over the course of the Class Period here, Plaintiffs allege that Defendants made numerous material misrepresentations and omissions primarily concerning the overwhelming scope of Freddie's non-prime and non-traditional loan purchases, which caused tremendous losses that decimated Freddie's capital position. These allegations, supported by a wealth of source material (including numerous confidential witnesses) and corroborated in various ways, easily satisfy the heightened pleadings standards of the PSLRA and Rule 9(b).

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[15] Indeed, Defendants' claim that Plaintiffs "simply ignore that Freddie Mac's stock had fallen by 40% during the class period, ***prior to*** the first purported corrective disclosure" (Def. Mem. at 21 (emphasis in original)) ignores numerous allegations showing how Freddie's stock price rose in response to specific false statements, and then dropped in response to negative news unique to Freddie. It also highlights the fact that this issue cannot be resolved at the motion to dismiss stage because expert testimony will be needed to ascertain the basis for certain stock price movements. Expert testimony on the impact of stock price movements would require the use of an event study. *In re Flag Telecom Holdings, Ltd. Sec. Litig.*, 245 F.R.D. 147, 169 (S.D.N.Y. 2007) ("In reaching his conclusions, [the expert] employed what is commonly termed as an event study. In the majority of applications, the focus of an event study is the effect of an event on the price of a particular class of securities of the firm, most often common equity.").

First, the Complaint identifies numerous statements where Defendants misled the market regarding the extent of Freddie's exposure to non-prime and non-traditional loans, including statements that: (1) "[w]e didn't do any subprime business;" (2) "we continue to benefit from a relatively strong credit position;" (3) "our portfolio . . . remains one of the strongest in the mortgage/finance industry;" (4) "[t]he credit profile of our retained portfolio remains of the highest credit quality;" (5) "we're a high-leverage, low-risk operation;" (6) "our mortgage portfolio is low in loan-to-value, low in holdings of exotic loans, high in regional diversification and high in credit quality;" (7) the "impairment of mortgage-related securities backed by subprime collateral is temporary;" (8) "we don't have impairments on the ABS portfolio;" and (9) "this is a very, very well insulated portfolio." ¶¶445, 447, 459-61, 463, 466, 474, 480, 489, 491, 504, 507, 509, 515-16, 519. In addition, Defendants falsely reported the actual amount of Freddie's non-prime and non-traditional loan holdings in its financial statements. ¶¶444, 477, 506.

These and other related statements were false and misleading because, despite constant internal warnings, Freddie devoured risky loans for both its guarantee and retained portfolio lines of business to the extent that, prior to and during the Class Period, such loans comprised 50% of the Company's single family purchases and approximately 32% of the Company's total risk exposure. ¶¶3, 9, 94-125, 163-69. To that end, several confidential witnesses explained how Freddie substantially increased the scope of its non-prime loan purchases and then hid such purchases from investors by misclassifying them as prime loans or by using a contrived definition of the term "subprime" in public disclosures. ¶¶98-122, 143-60. Bolstering such evidence, the Complaint further describes the congressional testimony of various witnesses, such as Edward Pinto, a former high ranking executive at Fannie, who, after analyzing nonpublic Freddie documents, stated, under oath, that Freddie's non-prime and non-traditional loan exposure was far greater than Defendants had publicly reported. ¶¶161-67, 301-06, Exh. C (Declaration of Edward Pinto). Finally, the Complaint demonstrates that, despite the fact that every economic indicator showed that Freddie's non-prime loans were severely impaired, Freddie refused to write-down ***any*** of those loans to fair value in violation of GAAP. ¶¶243-51, 352-428.

Second, the Complaint also alleges that Defendants falsely assured (and then reassured) the market – even in the face of a government takeover – of the Company's secure capital position, touting that the Company was well-insulated from, and, in fact, well-positioned to exploit, the downturn in the housing market. *See* ¶¶3, 7-8. In this regard, Defendants misrepresented, *inter alia*, that: (1) "the combination of our existing capital base, our capital raise, and the regulatory relief, puts us in a very strong capital position;" (2) "we are deliberately putting ourselves in a very, very strong capital position"; (3) "we have a very solid capital base"; (4) "our capital is intact;" (5) "we think we've acted prudently and decisively to protect and bolster our capital;" (6) "we will have a substantial capital cushion;" and (7) "Freddie Mac is not on the threshold of conservatorship because we are adequately capitalized." ¶¶448, 472, 478-80, 490, 504, 507, 510, 515, 519, 525-26, 530, 539, 549-50. Moreover, in connection with Freddie's mandatory capital requirements, Defendants grossly overstated its core capital numbers. ¶¶441, 448, 472, 475, 504.

These and other related statements were false and misleading because, due to expected massive losses attributable to risky non-prime and non-traditional loans, the Company's capital position was woefully inadequate to the point that Freddie was effectively insolvent throughout the Class Period. ¶¶243-51, 299, 322-41. Defendants hid Freddie's capital inadequacy from the market through creative accounting machinations relating to the failure to take fair market impairments and the abuse of the deferred tax assets. ¶¶429-38, 538, 555. In fact, once federal regulators reviewed Freddie's books, they discovered that the Company's capital position was nowhere close to what was publicly stated, and moved quickly to rescue the Company before, ultimately, placing it into conservatorship. ¶¶299-300, 529-31, 535, 563-64.

Third, the Complaint avers that Defendants misrepresented material facts concerning the sufficiency of Freddie's underwriting, due diligence and quality control practices, including statements that: (1) "[w]e have begun raising prices, tightened our credit standards, and enhanced our risk management practices;" (2) "[w]e subsequently review a sample of these loans and, if we determine that any loan is not in compliance with our contractual standards, we may require the seller/servicer to repurchase that mortgage or make us whole in the event of default;" (3) '[w]e

regularly monitor the performance of mortgages using these systems and standards . . . ;" (4) "[a]s part of our post-purchase quality control review process, we use Loan Prospector to evaluate the quality control of virtually all single-family mortgages that were not evaluated by Loan Prospector prior to purchase;" (5) "[a]s part of our risk management practices, we have adopted a set of limits on our purchases and holdings of certain types of non-traditional loans;" and (6) "we have improved our underwriting standards by insisting on better credit quality for new guarantees and reducing our volumes of riskier loan products." ¶¶441, 472, 476, 489, 491, 504-05, 507, 537.

These and other related statements are false and misleading because, despite dire warnings about the risks associated with the performance of non-prime and non-traditional loans, Defendants failed to implement any significant reforms to mitigate those risks. ¶¶81-93, 221-242. Further, in an effort to close as many deals as possible, Defendants ***loosened*** (not tightened) Freddie's underwriting standards and limited efforts to conduct meaningful due diligence, particularly with respect to large-scale bulk and structured deals containing huge numbers of junk loans. ¶¶98-99, 101-02, 104-22, 170-74. Even where due diligence was attempted, those efforts were hampered by antiquated internal systems, such as Loan Prospector, that could not properly distinguish between traditional and exotic loans. ¶¶175-220. To avoid problems with loan originators, the Company readily accepted troublesome loans under pre-set rejection rates, discontinued repurchasing practices for defaulting loans, failed to review a sample of loans until after default, and failed to employ valuable credit enhancements or other mortgage insurance. *Id*.

Accordingly, because the Complaint pleads the falsity of Defendants' statements with the particularity required by the PSLRA,[16] Defendants' grab-bag of "legal" challenges should be disregarded.

[16] Among the various source materials referenced in the Complaint, Plaintiffs rely on numerous confidential witnesses who provided their personal knowledge of Freddie's operations prior to and during the Class Period. The Second Circuit recognizes that a plaintiff may plead its case using confidential witnesses provided that "they are described in the complaint with sufficient particularity to support the probability that a person in the position occupied by the source would possess the information alleged." *Novak*, 216 F.3d at 314. Plaintiff easily satisfies this standard. In a lengthy section of the Complaint, Plaintiffs identify 27

a. Plaintiffs Sufficiently Allege Violations of GAAP

Defendants claim that Freddie's financial statements are not false because Plaintiffs do not plead that Defendants committed violations of GAAP. While posed as an issue of particularity, Defendants' real argument is that their "highly subjective accounting decisions" did not violate GAAP. Def. Mem. at 27-28 (no violations of FAS 115 based on "specific contractual terms of Freddie Mac's securities" and "rapidly changing economic landscape"); *id.* at 28-29 (no violation of FAS 109 based on Freddie's "strong earnings history" and "largest decline in single-home values in recorded history"). But the issue of whether Defendants actually violated GAAP is a factual question not appropriate for resolution at the motion to dismiss stage. *See, e.g., In re Global Crossing, Ltd. Sec. Litig.*, 322 F. Supp. 2d 319, 339 (S.D.N.Y. 2004) ("Although the question of whether GAAP has been violated might appear to be a legal determination, the element of what is 'generally accepted' makes this difficult to decide as a matter of law."); *Barrie v. Intervoice-Brite, Inc.*, 397 F.3d 249, 257 (5th Cir. 2005) (in rejecting defendants' argument that "their accounting methods were not improper and that they made no false statements regarding earnings," the Fifth Circuit held that "[w]e agree with the plaintiffs that the defendants' argument is fact-based and is therefore insufficient to support a motion to dismiss . . . . Because the accounting questions in this case are disputed, dismissal was not appropriate.").

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confidential witnesses on which they rely, describing their title, length of employment, supervisors and responsibilities. ¶¶35-63. Then, throughout the remainder of the Complaint, Plaintiffs attribute specific statements about Freddie's operations to specific confidential witnesses. To this end, contrary to Defendants' complaints, it makes perfect sense that a Director of Operational Risk Management, a Senior Risk Analyst and an Operational Risk Manager can testify competently on the risks that non-prime and non-traditional loans had on the Company, which were ignored by the Individual Defendants. ¶¶37, 45, 57. Similarly, those witnesses involved with Freddie's non-performing loans, such as a Financial Analyst Manager, a Senior Default Specialist, and a Senior Financial Analyst can provide firsthand knowledge of the overall disastrous performance of non-prime loans contained in Freddie's portfolio. ¶¶40-41, 44. *In re Scottish Re Group Sec. Litig.*, 524 F. Supp. 2d 370, 392-93 (S.D.N.Y. 2007) ("The CWs, all of whom claim knowledge of a systemic failure in the Company's ability to manage its financial information, occupied positions that would have allowed for relevant hands-on experience in various parts of the Company. Because the CWs' allegations are sufficiently particular as to support their plausibility, they state a claim without regard to plaintiffs' other allegations.").

Nevertheless, Plaintiffs adequately allege that Defendants violated GAAP in connection with Freddie's accounting for "available for sale" investments under FAS 115. ¶¶352-428. That principle provides that, if it is probable that an investor will be unable to collect all amounts due according to the contractual terms of a debt security, an "other-than-temporary impairment" has occurred, which requires the investor to write-down the value of the security to fair value. ¶¶360-63. During the Class Period, though, Freddie refused to record ***any*** impairments to its "available for sale" securities, despite the fact that the probability of collection was virtually non-existent due to, *inter alia*: (i) decreasing home values; (ii) rising interest rates; (iii) skyrocketing defaults and delinquencies; (iv) substantial credit rating downgrades; (v) insolvencies of major mortgage insurers; and (vi) massive impairments taken by similarly situated companies. ¶¶364-428. Once it was placed into conservatorship, Freddie could no longer hide its GAAP violations, belatedly recording ***$22.5 billion*** in other-than-temporary impairments and admitting to existing material weaknesses in its ability to determine such impairments. ¶¶426-28.[17]

Similarly, Plaintiffs adequately allege that Defendants violated GAAP by overstating the value of Freddie's deferred tax assets under FAS 109. ¶¶429-38. FAS 109 provides that, when it is "more likely than not" that some or all of a company's deferred tax assets, representing tax benefits accumulated over time to offset future profits, will not be realized due to an uncertainty about the company's future taxable income, the deferred tax assets should be written off against earnings. ¶¶430, 433-34. Although during the Class Period there existed overwhelming evidence that Freddie would incur considerable losses for the foreseeable future – as Defendants correctly acknowledged –

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[17] Defendants claim that Plaintiffs' application of FAS 115 is wrong because it "ignore[s] the specific contractual terms of Freddie Mac's securities" relating to credit enhancements and that certain "'subjective determinations' were made prior to the severe economic decline that occurred during the third quarter of 2008." Def. Mem. at 27-28. These factual arguments do not withstand scrutiny. First, Plaintiffs specifically allege that Freddie did not regularly use credit enhancements on non-traditional loans. ¶¶207-08, 244. Second, since the severe economic decline referenced by Defendants (which, in fact, they played a substantial role in creating and perpetuating) began well before the third quarter of 2008, all available economic data should have alerted Defendants that the value of their non-prime loan holdings was seriously impaired by the start of the Class Period. ¶¶371-428.

Defendants increased, rather than decreased, the value of Freddie's deferred tax assets to the point that, as of March 31, 2008: (i) they exceeded the Company's entire net worth by nearly 20%, and (ii) they comprised nearly 50% of the Company's core capital requirements. ¶¶431-32. Due to the extreme unlikelihood that Freddie would realize the benefits of its deferred tax assets, Defendants should have written down the value of such assets and, relatedly, the amount of its capital position well before the government forced Freddie into conservatorship. ¶¶435-38; s*ee In re Huffy Corp. Sec. Litig.*, 577 F. Supp. 2d 968, 1016-17 (S.D. Ohio 2008) (court upheld allegations for violations of FAS 119 where plaintiff pled that "it was highly unlikely that Gen-X would generate sufficient taxable income to support utilization of the deferred tax assets before they expired.").[18]

Accordingly, these GAAP allegations demonstrate that Freddie's financial results were false and misleading when made. Plaintiffs identify the specific GAAP rules that Defendants violated and sufficiently describe precisely how they were violated. Putting aside Defendants' fact-based denials, nothing more is required at the motion to dismiss stage. *See Barrie*, 397 F.3d at 257 (to plead violations of GAAP, a plaintiff must state: "the existence of a rule [governing the accounting for the transaction in question]; [the defendants'] acceptance of that rule; [the defendants'] publication of financial information in violation of that rule; and [the defendants'] admission of that violation.").

b. Defendants Had a Duty to Disclose Omitted Information

Defendants broadly argue that they "had no duty to disclose the allegedly omitted information" concerning the Company's non-prime and non-traditional loan exposure, capital adequacy or quality control problems because: (1) "Plaintiff does not allege that any actual statement was 'so incomplete as to mislead;'" (2) "Plaintiff's allegations of business management do not state

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[18] Defendants assert that Plaintiffs wrongly applied FAS 109 by refusing to acknowledge Freddie's strong earnings history and that the losses Freddie incurred were an aberration caused by the (in part self-created) economic crisis. Def. Mem. at 29. But, by the time of the Class Period, Freddie's strong earnings history was a thing of the past as it had already incurred billions of dollars of quarterly losses. ¶437. And, given the known losses attributable to its enormous non-prime and non-traditional loan investments, Defendants had no reasonable expectation that Freddie would earn any profits for the foreseeable future. Thus, as with their FAS 115 arguments, these factual disputes are without merit.

a claim for violation of the federal securities laws;" and (3) "Defendants disclosed much of the allegedly omitted information." Def. Mem. at 41; *see also* I.D. Mem. at 7-9. In essence, Defendants challenge the materiality of their alleged misstatements.

"[I]n order for the misstatement to be material, there must be a substantial likelihood that the disclosure of the omitted fact would have been viewed by the reasonable investor as having significantly altered the 'total mix' of information made available." *ECA & Local 134 IBEW Joint Pension Trust of Chicago v. JP Morgan Chase Co.*, 553 F.3d 187, 197 (2d. Cir. 2009). Noting that materiality requires a "fact-specific inquiry" that "necessarily depends on all relevant circumstances," the Second Circuit advises that "a complaint may not properly be dismissed on the ground that the alleged misstatements or omissions are not material unless they are so obviously unimportant to a reasonable investor that reasonable minds could not differ on the question of their importance." *Id*. Given this standard, the hodgepodge of nondescript materiality attacks raised by Defendants are easily overcome.

(1) Defendants' Statements Were Materially Incomplete

While, as Defendants point out, there can be no fraud absent a duty to speak, once a corporation has elected to speak, Rule 10b-5 mandates that its speech must be truthful, accurate, and complete. *See Caiola v. Citibank, N.A.*, 295 F.3d 312, 331 (2d Cir. 2002) ("Upon choosing to speak, one must speak truthfully about material issues. Once [a company] chose to discuss its hedging strategy, it had a duty to be both accurate and complete."). Further, "even an entirely truthful statement may provide a basis for liability if material omissions related to the content of the statement make it--or other statements made--materially misleading." *In re Bristol Myers Squibb*, 586 F. Supp. 2d at 160; *Fogarazzo v. Lehman Bros.*, 341 F. Supp. 2d 274, 294 (S.D.N.Y. 2004) ("A statement can also be misleading, though not technically false, if it amounts to a half-truth by omitting some material fact.").

There is no dispute that, throughout the Class Period, Defendants repeatedly spoke to the market about Freddie's limited non-prime and non-traditional loan exposure, its capital position and its underwriting capabilities. *See, e.g.*, ¶¶441, 444-49, 476. But their statements on these issues

were anything but truthful and complete. Instead, as described above, Defendants failed to disclose that, due to loosened underwriting standards and virtually nonexistent due diligence, Freddie was able to materially increase the scope of its non-prime and non-traditional loan purchases, which eventually caused tremendous losses that eliminated the Company's capital. As such, in light of the detailed facts set forth in the Complaint, Defendants' statements were not merely incomplete, but, in many cases, they were demonstrably false.[19]

(2) Plaintiffs Allege Fraud, Not Mismanagement

Pointing to numerous operational activities set forth in the Complaint, Defendants contend that "[m]any of the omissions the Plaintiff alleges are also not actionable because they amount to no more than claims of supposed corporate mismanagement." Def. Mem. at 42. This misses the mark. Far from "mismanagement" or a failure to anticipate a downturn in the market, the Complaint explains that ***undisclosed*** and ***concealed*** misconduct occurring ***during the Class Period***, and known to Defendants, materially contributed to, and accelerated, the economic meltdown, and contradicted Defendants' positive statements about the quality of the Company's mortgage portfolio, financial outlook and future business prospects.

Indeed, Plaintiffs do not take issue with the various wrongheaded management decisions made by Defendants prior to and during the Class Period. For example, Syron could (and did) cause Freddie to undertake an inordinate amount of risk by engaging in extensive non-prime and non-traditional loan purchases. The problem, of course, is his failure to fully inform the market of this

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[19] Defendants' heavy reliance on *Backman v. Polaroid Corp.*, 910 F.2d 10 (1st Cir. 1990) is misplaced. There, the First Circuit recognized the well-established principle that, while a "voluntary disclosure of information" must be "complete and accurate," it does not follow that "by revealing one fact about a product, one must reveal all others that, too, would be interesting, market-wise." *Id*. at 16. Instead, a company must reveal sufficient information to prevent its statements from being "so incomplete as to mislead." *Id*. Contrary to Defendants' suggestion, this common sense statement of the law is neither "narrow" nor "limited." Def. Mem. at 41. It is consistent with Second Circuit law. *See Caiola*, 295 F.3d at 331. Applied here, Plaintiffs adequately alleged that Defendants' statements were materially incomplete because they omitted information concerning, among other things, Freddie's shoddy underwriting practices, which allowed Defendants to increase the scope of Freddie's non-prime and non-traditional loan exposure and caused Freddie to incur losses that decimated its capital position.

fact. *In re JPMorgan Chase Sec. Litig.*, 363 F. Supp. 2d 595, 617 (S.D.N.Y. 2005) ("Although the federal securities laws do not require a corporation to 'accuse itself of wrongdoing,' they do prohibit misrepresentation of material facts, even when those material facts relate to corporate mismanagement."). Thus, Defendants are not liable in this action for their complete lack of sound business judgment, but for their misrepresentations regarding the exercise of that business judgment.[20]

(3) Defendants' "Disclosures" Were Demonstrably False

As described above, Plaintiffs allege that Defendants' statements concerning the Company's non-prime and non-traditional exposure, capital adequacy, and underwriting activities were false and misleading when made. Nonetheless, ***citing to those very same misstatements***, Defendants claim that Plaintiffs could not have been materially misled because Freddie "actually disclosed much of the allegedly omitted information" to the market. Def. Mem. at 45. This type of *ipse dixit* response is baseless.

The Second Circuit has explained that, under the "so-called 'truth on the market' corollary to [the] 'fraud on the market'" presumption:

> a misrepresentation is immaterial if the information is already known to the market because the misrepresentation cannot then defraud the market. A defendant may rebut the presumption that its misrepresentations have affected the market price of its stock by showing that the truth of the matter was already known. However, the corrective information must be conveyed to the public with ***a degree of intensity and credibility sufficient to counter-balance effectively any misleading information created by the alleged misstatements.***
>
> The truth-on-the-market defense is intensely fact-specific and is rarely an appropriate basis for dismissing a §10(b) complaint for failure to plead materiality.

[20] *In re Citigroup Inc. S'holder Derivative Litig.*, 964 A.2d 106 (Del. Ch. 2009) does not help Defendants here. That case involved a claim that several directors breached their fiduciary duty of oversight owed to Citigroup by failing to "see the extent of Citigroup's business risk" and making "a 'wrong' business decision by allowing Citigroup to be exposed to the subprime mortgage market." *Id*. at 130. Unlike this action, *Citigroup* does not involve public misrepresentations regarding the scope of the risk undertaken.

Ganino v. Citizens Utils. Co., 228 F.3d 154, 167 (2d Cir. 2000); *Hall v. Children's Place Retail Stores, Inc.*, 580 F. Supp. 2d 212, 226 (S.D.N.Y. 2008) ("Under the 'truth-on-the-market' doctrine, information already known on the market is also immaterial.").

Putting aside the falsity of those statements, Defendants cannot realistically claim that general "disclosures" – including: (i) "we have increased our participation" in the non-traditional mortgage market; (ii) "[m]arket uncertainty and volatility may adversely affect our business, profitability, results of operations and capital management;" and (iii) there is "additional credit risk inherent" in non-traditional mortgage products (*see* Def. Mem. at 8-9, 45-48) – contain the "degree of intensity and credibility" necessary to warn investors of the serious and foreseeable financial risks impacting the Company throughout the Class Period. *See, e.g.*, *Children's Place*, 580 F. Supp. 2d at 229 ("While some facts regarding the maintenance of the Disney Stores were known, many were not. Disclosures such as the 'ratcheting down' of the Disney Stores remodeling efforts did not fully reveal the numerous breaches of the License Agreement that occurred during 2006-2007."); *In re Comverse Tech., Inc. Sec. Litig.*, 543 F. Supp. 2d 134, 150 (E.D.N.Y. 2008) ("A fact-finder could reasonably find that in order to 'counter-balance effectively' its previous misstatements, Converse [sic] would have had to both issue restated financial statements, or an estimate thereof, and inform shareholders that its executives had engaged in deliberately fraudulent behavior. The April 17, 2006 Press Release did neither.").

Even more problematic than the generality of Defendants' disclosures is their failure to appreciate the nature and scope of the Complaint's allegations. Incredibly, Defendants state that "Plaintiff does not challenge that accuracy of any of the hard data that Freddie Mac disclosed, which described with precision the extent of Freddie Mac's investment in subprime and nontraditional loans." Def. Mem. at 48; I.D. Mem. at 9. Defendants' rhetoric cannot be taken seriously, as this "hard data" is precisely what Plaintiffs challenge in the Complaint, along with other statements falsely characterizing Freddie's loan portfolio as "sound" or "strong," and falsely assuring the market that, despite expected losses arising from non-prime loans, the downturn in the U.S. housing market ***actually presented an opportunity for the Company to grow and prosper.*** ¶¶441, 445, 447,

474; *see Lapin v. Goldman Sachs Group, Inc.*, 506 F. Supp. 2d 221, 238 (S.D.N.Y. 2006) ("Thus, the Court concludes there are sufficient facts pled to question whether the alleged 'truth-on-the-market' was said with the degree of intensity and credibility sufficient to counter-balance any allegedly misleading statements made by Defendants."); *Wieland v. Stone Energy Corp.*, 2007 U.S. Dist. LEXIS 76636, at *35 (W.D. La. Aug. 17, 2007) ("Thus, although as of October 6, 2005 the market knew of the general problems regarding Stone's proved reserve estimates, there are factual issues concerning whether the full extent and effect of those problems was known at that time.").

Further undercutting the supposed effectiveness of Defendants' "truthful" disclosures is the understanding of market analysts and commentators concerning the Company's loan holdings and risk exposure during the Class Period. For example, on July 14, 2008, following Freddie's efforts to discount news reports of a governmental rescue plan, the *USA Today* reported that Freddie and Fannie "maintain fairly stringent requirements for the mortgages they buy. They don't touch subprime mortgage or many of the exotic types of loans that helped fuel the real estate bubble." ¶139. Similarly, on July 14, 2008, Nobel Prize winning economist Paul Krugman wrote in an op-ed piece in the *New York Times* that Freddie and Fannie "didn't do any subprime lending, because they can't: the definition of a subprime loan is precisely a loan that doesn't meet the requirement, imposed by law, that Fannie and Freddie buy only mortgages issued to borrowers who made substantial down payments and carefully documented their income." ¶140. On July 15, 2008, Senator Christopher Dodd, in his opening statement at the United States Senate Banking Committee hearing on "Recent Developments in U.S. Financial Markets and Regulatory Responses to Them," stated that Freddie and Fannie "have solid portfolios with relatively few risky subprime mortgages." ¶141. Such a misunderstanding by those who professionally follow Freddie unequivocally contradicts Defendants' assertion that ordinary investors were on notice of Freddie's risks and resultant losses. *See, e.g., In re Resource Am. Sec. Litig.*, 2000 U.S. Dist. LEXIS 10640, at *13 (E.D. Pa. July 26, 2000) (court rejected truth-on-the-market arguments where "Plaintiffs allege that Resource America, Inc.'s accounting scheme as a whole was misleading, and that as a consequence the significance of the raw information disclosed to the public was not susceptible to understanding

even by the most sophisticated investors."); *Freeland v. Iridium World Commc'ns, Ltd.*, 545 F. Supp. 2d 59, 79 (D.D.C. 2008) ("Given the evidence cited by Plaintiffs, as well as the common sense observation that, despite all the information cited by Motorola, the market was terribly wrong about Iridium's prospects, the Court cannot say at the summary judgment stage that no reasonable jury could find that the market was misled.").

c. Defendants' Statements Were Not Meaningless Puffery

Characterizing many of their statements as "immaterial puffery," Defendants claim that "vague and indefinite statements of optimism" concerning Freddie's "risk management," "market position" and "performance" "cannot give rise to liability under the federal securities laws." Def. Mem. at 52-53; I.D. Mem. at 6-7. This argument ignores the bulk of the specific and substantive misrepresentations in the Complaint regarding Freddie's massive investment in non-prime and non-traditional loans, and the overwhelmingly deleterious impact such investments were having on the Company's credit risk, capital position, and financial condition. And it completely discounts the unique position that Freddie serves in the residential mortgage marketplace.

Ordinarily, "[m]ere expressions of puffery and corporate optimism do not give rise to securities violations" because such statements "are not capable of objective verification." *Tower Auto.*, 483 F. Supp. 2d at 336. "Opinion statements are actionable, however, if Plaintiffs can plead with particularity that defendants did not sincerely believe the opinion they purported to hold, or if they are worded as guarantees or are supported by specific statements of fact." *Malin v. XL Capital Ltd.*, 499 F. Supp. 2d 117, 144-45 (D. Conn. 2007), *aff'd*, 2009 U.S. App. LEXIS 4984 (2d Cir. Mar. 5, 2009); *see also Novak*, 216 F.3d at 315 ("While statements containing simple economic projections, expressions of optimism, and other puffery are insufficient, defendants may be liable for misrepresentations of existing facts."). "Whether the opinion or 'soft information' is indeed actionable depends on all relevant circumstances of the particular case, and is generally not an appropriate basis on which to dismiss a complaint at this stage of the action." *In re Vivendi Universal, S.A. Sec. Litig.*, 381 F. Supp. 2d 158, 182 (S.D.N.Y. 2003).

Not surprisingly, in determining whether certain statements are material, context matters. This is particularly true in the case of Freddie, which served a critical role in the real estate market and the U.S. economy. Indeed, Freddie was "established to facilitate liquidity in the home mortgage market and to promote homeownership." *In re Fed. Home Loan Mortgage Corp. Derivative Litig.*, 2009 U.S. Dist. LEXIS 65143, at *4 (E.D. Va. July 27, 2009). Consistent with this role, Defendants publicly bragged that, while the residential mortgage market was tanking, "the GSEs were set up for times like these" and the Company is a "rather unique financial institution" chartered to "provide liquidity, stability, and affordability across the cycles, good times and bad, to [its] customers." ¶¶446, 459. Thus, Defendants' misstatements about Freddie's "strong" credit position and "sound" policies must be judged against this backdrop. *Lapin*, 506 F. Supp. 2d at 240 ("[T]he Second Amended Complaint does more than identify rosy predictions or vague statements about Goldman's integrity; Goldman stated that such integrity 'was at the heart' of its business and attempted to distinguish itself from other institutions based on its 'truly independent investment research' while it allegedly knew the contrary was true."); *In re Moody's Corp. Sec. Litig.*, 599 F. Supp. 2d 493, 509 (S.D.N.Y. 2009) (in context, misstatements regarding "integrity" and "independence" were "neither 'vague' nor 'non-specific' pronouncements that were incapable of 'objective verification.'").

Contrary to Defendants' "puffery" argument, the Complaint pleads numerous objectively verifiable misrepresentations concerning the Company's loan portfolio, credit profile and capital position. As extensively detailed in the Complaint, Plaintiffs allege that these statements were materially false and misleading because Defendants deliberately acquired massive amounts of risky non-prime and non-traditional loans to increase the Company's market share, and concealed their plans to do so from shareholders. These efforts exponentially increased the Company's credit risk and, ultimately, forced the Company to incur tremendous losses as these loans defaulted at a staggering rate, which eroded the Company's capital position. Thus, contrary to their boasts throughout the Class Period, Freddie was not "safe and sound," it was not taking "strong steps" to improve its business, its credit position was not "strong," and it was not "well positioned" to survive the economic crisis. *See* ¶¶441, 445, 474.

Under such circumstances, Defendants' claims that their statements constitute immaterial puffery fall flat. *See, e.g.*, *Countrywide*, 588 F. Supp. 2d at 1144 ("[T]he CAC adequately alleges that Countrywide's practices so departed from its public statements that even 'high quality' became materially false or misleading; and that to apply the puffery rule to such allegations would deny that 'high quality' has any meaning."); *New Century*, 588 F. Supp. 2d at 1225-26 ("The Court also finds that the alleged statements cannot be chalked up to 'mere puffery' . . . . Here, Plaintiffs offer New Century's statements that it observed standards of high-quality credit and underwriting, and set those statements against detailed allegations of practices that utterly failed to meet those standards. That is sufficient to plead false and misleading statements."); *Novak*, 216 F.3d at 315 ("Here, the complaint alleges that the defendants did more than just offer rosy predictions; the defendants stated that the inventory situation was 'in good shape' or 'under control' while they allegedly knew that the contrary was true.").

d. The PSLRA's Safe Harbor and the Related Bespeaks Caution Doctrine Do Not Apply

Defendants further argue that many of their false and misleading statements are inactionable because they were "forward-looking statements" accompanied by meaningful cautionary language, and thus fall under the PSLRA's "safe harbor" or the related bespeaks caution doctrine. Def. Mem. at 54-56; I.D. Mem. at 6-7. But these defenses do not provide Defendants with the broad immunity they now seek.[21]

As an initial matter, Defendants' argument for safe harbor protection is premature. *See Asher v. Baxter Int'l, Inc.*, 377 F.3d 727, 734 (7th Cir. 2004) (reversing trial court's granting of motion to dismiss). As the Court found in *Asher*, because the language of safe harbor is so malleable, it is

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[21] It is undisputed that "[r]epresentations of historical or current fact do not qualify for the PSLRA's safe harbor." *In re Regeneron Pharms., Inc. Sec. Litig.*, 2005 U.S. Dist. LEXIS 1350, at *38-39 (S.D.N.Y. Feb. 3, 2005); *In re Ins. Mgmt. Solutions Group, Inc. Sec. Litig.*, 2001 U.S. Dist. LEXIS 9962, at *29-30 (M.D. Fla. July 11, 2001) ("If the statements are not considered forward-looking statements, neither the PSLRA nor the 'bespeaks caution' doctrine apply."). Thus, these defenses simply do not apply to most of Defendants' false and misleading statements.

unsuitable to apply on a motion to dismiss. *Id*. ("There is no reason to think – at least, no reason that a court can accept at the pleading stage, before plaintiffs have access to discovery – that the items mentioned in [Defendants'] cautionary language were those" that were realized when the truth emerged.); *see also Blatt v. Corn Prods. Int'l, Inc.*, 2006 WL 1697013, at *5 (N.D. Ill. June 14, 2006) ("[W]hether the cautions at issue here were adequate is a not [sic] question to be answered on a motion to dismiss. The sufficiency of Defendants' cautionary tone (if, indeed, one was required) is a question of fact, or possibly a question of law, that can be answered only on a more developed record.").

Even if the Court were to entertain Defendants' safe harbor or bespeaks caution arguments, Defendants cannot seriously contend that their statements were accompanied by ***meaningful*** cautionary language. General warnings that economic conditions may cause a decline in mortgage holdings and, it follows, the Company's financial results, are insufficient to place investors on notice of the risk inherent in their investment. *Vivendi Universal*, 381 F. Supp. 2d at 183 (cautionary language must "identify important factors that could cause actual results to differ materially from those in the forward-looking statements."). Nothing about Defendants' so-called cautionary language warned investors that the Company's projections and other forward looking statements were undermined by its massive exposure to losses arising from risky non-prime and non-traditional loans. *Lormand*, 565 F.3d at 247-48 ("The misrepresentations and omissions were not accompanied by specific, concrete explanations that clearly identified and quantified the clearly present financial dangers to US Unwired, *i.e.*, the disastrous effects of the no-deposit programs and US Unwired's loss of control of customer care, billings and cash flow.").

And Defendants cannot justifiably blame the broader context of a decline in the U.S. economy when the Complaint unmistakably pleads that their conduct materially contributed to and exacerbated that decline. Simply, neither the safe harbor nor the bespeaks caution doctrine "provides [any] protection to someone who warns his hiking companion to walk slowly because there might be a ditch ahead when he knows with near certainty that the Grand Canyon lies one foot away." *Rombach v. Chang*, 355 F.3d 164, 173 (2d Cir. 2004); *In re Nash Finch Co. Sec. Litig.*, 502

F. Supp. 2d 861, 873 (D. Minn. 2007) ("[I]f Defendants knew that the specific risks and uncertainties stated to be 'potential' in their cautionary language had already been realized, and that their forward-looking statements were false and misleading, then their forward-looking statements were not protected by the safe harbor.").

Moreover, the PSLRA safe harbor is inapplicable because Plaintiffs have shown that when Defendants made forward-looking statements, they were made "with actual knowledge" of their falsity. 15 U.S.C. §78u-5(c)(1)(B); *In re NovaGold Res. Inc. Sec. Litig.*, 629 F. Supp. 2d 272, 291 (S.D.N.Y. 2009) ("The safe harbor does not apply to forward-looking statements if made with 'actual knowledge' that they are false or misleading."). Consequently, despite the protections afforded by the PSLRA's safe harbor or the bespeaks caution doctrine, forward-looking statements "are not protected where defendants had no basis for their optimistic statements and already knew (allegedly) that certain risks had become reality." *Children's Place*, 580 F. Supp. 2d at 226; *see also In re Blockbuster Inc. Sec. Litig.*, 2004 U.S. Dist. LEXIS 7173, at *19-20 (N.D. Tex. Apr. 26, 2004) ("If the representation or omission is fraudulent, independent of the existence of a forward-looking statement, the representation or omission is not shielded simply because a forward-looking statement exists."). The Complaint explains in painstaking detail precisely how Defendants knew their misstatements were false and misleading, thus abrogating application of the PSLRA's safe harbor and the bespeaks caution doctrine.

3. The Complaint Adequately Alleges Scienter

a. The Pleading Standard for Scienter

In a securities fraud action, "a plaintiff must also prove that the defendant acted with scienter, a mental state embracing intent to deceive, manipulate, or defraud." *Bristol Myers Squibb*, 586 F. Supp. 2d at 166. To allege scienter, the PSLRA directs that a complaint must, "with respect to each act or omission alleged to violate this chapter, state with particularity facts giving rise to a strong inference that the defendant acted with the required state of mind." *Rothman v. Gregor*, 220 F.3d 81, 90 (2d Cir. 2000). In the Second Circuit, "[t]he requisite scienter can be established by alleging facts to show either (1) that defendants had the motive and opportunity to commit fraud, or (2)

strong circumstantial evidence of conscious misbehavior or recklessness." *JP Morgan Chase*, 553 F.3d at 198.

In *Tellabs*, the Supreme Court articulated the standards for pleading a "strong inference" of scienter under the PSLRA: "A complaint will survive, we hold, only if a reasonable person would deem the inference of scienter cogent and at least as compelling as any opposing inference one could draw from the facts alleged." 551 U.S. at 324; *see also id*. at 326 ("In sum, the reviewing court must ask: When the allegations are accepted as true and taken collectively, would a reasonable person deem the inference of scienter at least as strong as any opposing inference?"); *id*. ("A plaintiff alleging fraud in a §10(b) action, we hold today, must plead facts rendering an inference of scienter ***at least as likely*** *as* any plausible opposing inference."). In each of these formulations, the Supreme Court effectively held that "ties" go to the plaintiff. *See, e.g., ACA Fin. Guar. Corp. v. Advest, Inc.*, 512 F.3d 46, 59 (1st Cir. 2008) ("[W]here there are equally strong inferences for and against scienter, *Tellabs* now awards the draw to the plaintiff."); *Heller v. Goldin Restructuring Fund, L.P.*, 590 F. Supp. 2d 603, 620 n.14 (S.D.N.Y. 2008) ("*Tellabs* clearly stands for the proposition that, if an 'inference of non fraudulent intent is equally permissible as any inference of fraudulent intent,' the complaint is properly pleaded.").

Explicitly rejecting a higher standard advocated by the *Tellabs* defendants, the Supreme Court further concluded that "[t]he inference that the defendant acted with scienter need not be irrefutable, *i.e.*, of the 'smoking-gun' genre, or even the 'most plausible of competing inferences.'" *Tellabs*, 551 U.S. at 324. To be sure, instead of a "most plausible of competing inferences" standard, *Tellabs* now instructs courts reviewing securities fraud complaints "not to scrutinize each allegation in isolation but to assess all the allegations holistically." *Id*. at 324, 326.

b. Defendants Were Uniquely Motivated to Commit Fraud

The Second Circuit recognizes allegations of motive are sufficient to establish scienter provided "plaintiffs . . . allege that defendants benefitted in some concrete and personal way from the purported fraud." *Novak*, 216 F.3d at 307-08. While general motive allegations attributable to ***any*** corporation are ordinarily insufficient, *see id*. at 307, this Court should consider Plaintiffs' motive

allegations within the context of the unique role that Freddie served in the residential mortgage marketplace.

As one of two GSEs, Freddie vigorously competes for market share with its sister company, Fannie. ¶¶95, 99, 105. Tasked with providing stability and liquidity in the residential mortgage market, Freddie and Fannie historically focused on purchases of low risk, conventional loans. ¶¶6, 22, 64, 78, 81. As the market for conventional loans matured in the years leading up to the start of the Class Period, Freddie and Fannie began to aggressively (and secretly) acquire huge numbers of riskier loans originated by various private lenders. ¶¶79-80, 82, 94-102, 105-106.

Thus, as the market for these exotic mortgage exploded, several perverse motives developed. For example, as indicated by confidential witness statements and other corroborating source materials, the Company intentionally loosened its underwriting and due diligence criteria due to the threat of losing deals in a "bidding war for market-share" with Fannie. ¶¶105-06. Concerned about the "pressure to remain relevant," and afraid that "[Freddie] couldn't afford to say no to anyone," the Individual Defendants caused Freddie to substantially increase its purchases of non-prime and non-traditional loans. ¶¶91, 108, 538. As a result of this desire to enhance short-term profitability, Freddie became one of the biggest buyers of non-prime loans from 2005 through 2007, far outpacing the transaction activity of Fannie during this time. ¶95.

Similarly, once they began to recognize the damage inflicted by this reckless investment strategy in 2007 and 2008, Defendants had little, if any, incentive to accurately report the Company's capital position. That is because Freddie's capital position, if reported correctly, would have violated the minimum capital requirements imposed by the government. "Significant undercapitalization," in turn, would limit the Company's ability to operate effectively and force Freddie's regulators to take drastic actions to remedy the Company's risk profile. And the harm to Freddie's reputation as a stabilizing force in the residential mortgage market would be (and eventually was) incalculable. *See* ¶¶322-41.

Accordingly, the dual motives of enhancing short-term profitability and staving off government interference, as detailed in the Complaint, are ***unlike*** those experienced by the average

company. In short, Freddie was created to stabilize the residential mortgage market; instead, its actions caused widespread chaos. As such, these motive allegations are sufficient to demonstrate scienter in this case.[22] *See Matrix Capital Mgmt. Fund, L.P. v. BearingPoint, Inc.*, 576 F.3d 172, 199 (4th Cir. 2009) ("Although motivations to raise capital are common to every company, in our holistic analysis of the FAC, the motive of personal financial gain renders the inference of scienter even more compelling."); *New Century*, 588 F. Supp. 2d at 1229 ("[T]he confidential witness statements describe a staggering race-to-the-bottom of loan quality and underwriting standards as part of an effort to originate more loans for sale through secondary market transactions.").[23]

c. Defendants Acted with Conscious or, at a Minimum, Reckless Disregard of the True State of Affairs at Freddie

A plaintiff may plead scienter "by alleging facts that constituted strong circumstantial evidence of conscious misbehavior or recklessness on the part of defendants." *Novak*, 216 F.3d 308.

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[22] Defendants' focus on market share and short-term profitability was no accident. Under the Company's executive compensation plans, the Individual Defendants were incentivized to take actions designed to "improv[e] market share and develop[] new capabilities to further penetrate the mortgage market." ¶130. Consequently, prior to and during the Class Period, the Individual Defendants were richly rewarded with lucrative salaries, bonuses and stock awards for undertaking the very actions that led to the Company's demise. ¶131. In fact, the Individual Defendants were expressly commended for their "market-leading response to early signs of the subprime crisis" and the "successful offering" of now worthless preferred stock. ¶132. In combination with those motives attributable to Freddie, the Court may consider these personal and concrete motives of the Individual Defendants as part of the scienter calculus. *No. 84 Employer-Teamster Joint Council Pension Trust Fund v. Am. W. Holding Corp.*, 320 F.3d 920, 944 (9th Cir. 2003) (scienter allegations sufficient where defendants "were motivated to inflate America West's financial results and stock prices because their eligibility for stock options and executive bonuses were based principally on the company's financial performance."). Finally, the Individual Defendants' argument that their executive compensation "fell by almost ninety percent from 2007 to 2008" (I.D. Mem. at 14) is a red herring because they were terminated based on the conservatorship and, obviously, could not receive any bonus or stock option grants at the end of 2008.

[23] Defendants argue that the "absence of stock sales . . . negates any inference of scienter." Def. Mem. at 38; *see also* I.D. Mem. at 11-12. This is no longer an accurate statement of the law. To be sure, in *Tellabs*, the Supreme Court recognized that "the absence of a motive allegation is not fatal." 551 U.S. at 325. Consequently, courts have held that the absence of allegations of unusual or suspicious stock sales will not defeat otherwise well pled allegations of scienter. *Siracusano v. Matrixx Initiatives, Inc.*, 2009 U.S. App. LEXIS 23716, at *39-40 (9th Cir. Oct. 29, 2009) (plaintiff adequately alleged scienter, despite the fact that "Appellants have not alleged that Appellees engaged in unusual or suspicious stock sales at the same time that they were attempting to downplay the reports of anosmia.").

"A securities fraud claim predicated upon recklessness or conscious misbehavior must allege the defendants' knowledge of facts contradicting their public statements, their failure to review information that they were obligated to monitor, or their ignorance of clear and obvious signs of fraud." *In re IMAX*, 587 F. Supp. 2d at 481. As an opening salvo, Defendants assert that the "Court can pull a fine tooth comb through the AC and not find ***one specific fact*** supporting any inference that any Defendant knew that any challenged statement was false." Def. Mem. at 31 (emphasis in original). Such hyperbole ignores the allegations in the Complaint and should be disregarded.

(1) Pre-Class Period Information

The Second Circuit has recognized that "pre-class data" may be used to demonstrate a defendant's requisite state of mind. *In re Scholastic*, 252 F.3d at 72 ("Pre-class data is relevant in this case, however, to establish that at the start of the class period, defendants had a basis for knowing increased Goosebumps sales were unlikely in the third quarter due to marked decreased sales experienced in the second quarter."). Here, the Complaint alleges several particularized pre-Class Period facts establishing that the Individual Defendants were specifically warned, and thus knew about, the serious risks involving investments in non-prime and non-traditional loans, and their impact on the Company's financial condition.

Throughout 2004, Freddie's Chief Risk Officer, Andrukonis, and other risk management executives repeatedly communicated to the Individual Defendants that Freddie should refrain from purchasing non-prime loans "as soon as practicable" because of their inherently risky nature and their potential to harm the Company's reputation, credit profile and financials. Andrukonis further warned that deteriorating underwriting standards would expose the Company to considerable losses. These warnings were ignored, as the Individual Defendants authorized Freddie to substantially increase non-prime and non-traditional loan purchases without oversight. For his efforts, though, Andrukonis was terminated. ¶¶83-88.[24]

[24] Defendants do not dispute the accuracy of these communications. Instead, they contend that these allegations fail to establish that any Class Period statements were knowingly false when made. Def. Mem. at

Additionally, in the midst of the economic crisis, Freddie's risk management personnel undertook concrete steps to understand the risks associated with the subprime crash. In August 2007, these executives convened approximately nine "risk scenario meetings" to discuss operational issues impacting the Company and create various strategies to minimize the risks related to defaulting non-prime non-traditional loans. The culmination of these efforts was a report – authored by Operational Risk Group Director Gareth Davies and approved by the Individual Defendants – that identified the numerous risks effecting the Company, analyzed those risks, and established plans to mitigate those risks through the development of certain "risk triggers." Despite the seriousness of the risks identified and overwhelming evidence that the "key risk indicators" were "coming to fruition," Freddie failed to implement the plans set forth in the report. ¶¶221-31.[25]

As the losses attributable to the Company's risky loans began to mount, numerous executives warned the Individual Defendants that such losses would adversely impact the Company's capital position. In fact, beginning in 2004, Freddie's head of capital compliance and oversight, Donald Solberg, repeatedly counseled Syron that the Company should maintain a thick capital cushion to withstand expected losses. Solberg's warnings, which continued until he left the Company in 2007, went unheeded by Syron and the other Individual Defendants. ¶¶235, 538.

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31 n.21. To the contrary, these allegations clearly show that the Individual Defendants knew of, and consciously disregarded, warnings that extensive non-prime and non-traditional loan investments would severely damage the Company.

[25] Failing (again) to contest the accuracy of these allegations, Defendants claim that they are "defective" because they are insufficiently particularized. Def. Mem. at 31; I.D. Mem. at 17-20. But Plaintiffs plead ***how many*** "risk scenario meetings" occurred, ***why*** they were held, ***where*** they were held, ***when*** they were held, ***who*** attended them, and ***what*** was discussed. Similarly, as to the Davies risk report, Plaintiffs allege ***why*** the report was created, ***when*** it was created, ***who*** signed off on it, and ***what*** it contained. ¶¶222-23. As such, these allegations comply with the particularity requirements of the PSLRA. *See In re Scholastic*, 252 F.3d at 72-73 ("Plaintiffs have satisfied this standard by specifying who prepared internal company reports, how frequently the reports were prepared and who reviewed them," as well as "additional indications as to the nature of the reports."). Contrary to Defendants' protests, no Second Circuit case "requires that the contradictory facts must be summarized in a single report that explicitly states the direct opposite of the misleading statement." *In re Dynex Capital, Inc.*, 2009 U.S. Dist. LEXIS 96527, at *50 (S.D.N.Y. Oct. 19, 2009).

(2) The Core Business Inference

A strong inference of scienter can be inferred here because the alleged misrepresentations relate to Freddie's core business activities – the purchase of residential mortgage loans and related securities to provide stability and liquidity to real estate market. *See, e.g.*, *In re Sears, Roebuck & Co. Sec. Litig.*, 291 F. Supp. 2d 722, 727 (N.D. Ill. 2003) (officers of a company can be assumed to know of facts "critical to a business's core operations or to an important transaction that would affect a company's performance"). That is, courts have repeatedly drawn the inference that "facts critical to a business's core operations or an important transaction generally are so apparent that their knowledge may be attributed to the company and its key officers." *In re PeopleSoft, Inc., Sec. Litig.*, 2000 U.S. Dist. LEXIS 10953, at *10 (N.D. Cal. May 26, 2000); *see also Nathenson v. Zonagen, Inc.*, 267 F.3d 400, 425 (5th Cir. 2001) (scienter element satisfied as to patent statement because information regarding patent protection was "obviously important," critical to company's core performance, and about which the company had "ample opportunity to become familiar"); *In re OCA, Inc. Sec. & Deriv. Litig.*, 2006 U.S. Dist. LEXIS 90854, at *60-64 (E.D. La. Dec. 14, 2006) (scienter properly alleged where defendants materially overstated value of company's largest asset).

On remand from the Supreme Court, the Seventh Circuit in *Tellabs* recognized it is "exceedingly unlikely" that top executives did not know facts about the corporation's "most important products," particularly where they communicated with the market about those products:

> The 5500 and the 6500 were Tellabs's most important products. The 5500 was described by the company as its 'flagship' product and the 6500 was the 5500's heralded successor. They were to Tellabs as Windows XP and Vista are to Microsoft. That no member of the company's senior management who was involved in authorizing or making public statements about the demand for the 5500 and 6500 knew that they were false is very hard to credit, and no plausible story has yet been told by the defendants that might dispel our incredulity.
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> * * *
>
> And at the top of the corporate pyramid sat Notebaert, the CEO. The 5500 and the 6500 were his company's key products. Almost all the false statements that we quoted emanated directly from him. Is it conceivable that he was unaware of the problems of his company's two major products and merely repeating lies fed to him

> by other executives of the company? It is conceivable, yes, but it is exceedingly unlikely.

Makor Issues & Rights, Ltd. v. Tellabs Inc., 513 F.3d 702, 709, 711 (7th Cir. 2008) ("*Tellabs II*").

Here, Defendants cannot legitimately dispute that the purchase and guarantee of mortgage loans was of vital importance to the Company's overall operations during the Class Period. Effusively describing how "[a] healthy and profitable Freddie Mac is essential for the stability of the U.S. housing system, and for the benefit of the entire U.S. economy," Defendants attributed expected improvements in Freddie's financial condition and future prospects to a number of "important steps [taken] to address the impact of declining housing and credit markets to [its] business," which included "raising prices," "tightened credit standards" and "enhanced risk management practices." *See, e.g.*, ¶¶441, 507. This also included, of course, Defendants' repeated proclamations that Freddie was a "low-risk operation" with a "strong credit position" and "a very, very well insulated portfolio." ¶¶447, 459, 516.

Moreover, throughout the Class Period, several critical events – all attributable to Freddie's need to satisfy the government-imposed minimum capital requirements – clearly demonstrated the Individual Defendants' awareness of issues concerning the Company's capital adequacy. ***First***, shortly after the beginning of the Class Period, Freddie successfully completed a preferred stock offering which enabled the Company to raise $6 billion. ¶¶12, 338, 453-54. According to Syron, the purpose of this offering was to "help us meet the 30 percent surplus and address regulatory concerns and GAAP accounting requirements." ¶453. ***Second***, despite successfully lobbying OFHEO to reduce the Company's capital requirements from 30% to 20%, the federal government, by March 2008, was privately urging Freddie to undertake additional capital raising activities, even threatening to publicly scold Freddie if they did not do so. ¶¶235, 479, 497, 533, 538. Addressing "rumors" of this government interference, Syron stated that "[t]his company will bow to no-one on our responsibility to the shareholders." ¶¶493, 538. Nonetheless, shortly thereafter, OFHEO announced an agreement with Freddie that would allow the Company to raise additional capital. ¶500. ***Third***, toward the end of the Class Period, the federal government took drastic actions to address Freddie's

dire capital situation, including the development of a rescue plan, the passage of "bailout" legislation, and the imposition of a conservatorship. ¶¶529, 535, 563-64.

As such, given the importance of the Company's "mission" and these critical events concerning the Company's capital position, the strong inference is that the Individual Defendants knew about truthful adverse facts existing during the Class Period relating to Freddie's non-prime and non-traditional loan exposure and inadequate capital position, as well as the exceedingly high likelihood such issues would negatively impact the Company's expected financial performance when the truth was revealed. *See In re Scottish Re Group*, 524 F. Supp. 2d at 394 ("It is simply not a plausible opposing inference that the Company's officers – sophisticated executives actively engaged in the planning of these transactions – were ignorant of the transactions' consequences on the Company's deferred tax assets.").

(3) The Position-Based Inference

Tied closely to the so-called "core business" inference, the Complaint further establishes the scienter of the Individual Defendants based on their high-ranking positions in the Company. The district court in *Countrywide* recently set forth the following principles governing a position-based inference of scienter:

> (1) a defendant's position within the company is a relevant circumstance to consider in the *Tellabs* analysis; (2) all particularized allegations about a defendant's activities and statements should be considered before making a position-based inference, just as in any *Tellabs* analysis; and (3) position alone creates a strong inference of scienter only in the extraordinary case where it is 'absurd to suggest' that a defendant did not know.

588 F. Supp. 2d at 1191. In fact, as discussed below, this is precisely one of those cases where it is "absurd to suggest" that the Individual Defendants, "by virtue of their positions, would not have knowledge of developments in core operations or important transactions." *Id*.

Indeed, much more than "boilerplate allegations" (Def. Mem. at 30) or fraud by hindsight (I.D. Mem. at 16), various Class Period admissions highlight Defendants' awareness of the Company's exposure to non-prime loan investments. As noted above, despite warnings from Freddie's risk management team, the Individual Defendants, as the top executives at the Company,

expressly authorized Freddie to expand its mortgage loan portfolio to include massive amounts of risky non-prime and non-traditional loans. ¶¶90-91. While these internal strategic decisions were implemented, Defendants publicly (and falsely) touted that Freddie had the underwriting and quality control processes in place to ensure that its portfolio was well protected. *See*, *e.g.*, ¶441.

For example, in various SEC filings and analyst conference calls, Piszel assured the market that the Company regularly monitored the performance of its mortgage portfolio: (a) "[w]e continued to make prudent provision for credit losses, monitor our credit book closely and maintain our disciplined approach to managing . . . risks;" (b) "we perform a very rigorous security-by-security analysis and given both our intent and our ability to hold securities until maturity, we have not identified any securities where losses are probable. We're watching all aspects of our ABS holdings very closely . . . ;" and (c) "we have an analysis that shows what the cumulative defaults have been, the cumulative delinquencies have been on these [ABS] portfolios." ¶¶504, 507, 509, 516. These and other similar statements demonstrate that, at a minimum, the Individual Defendants should have been aware of the adverse impact of risky loans on the Company's financial condition. *Novak*, 216 F.3d at 308 ("[W]e have found allegations of recklessness to be sufficient where plaintiffs alleged facts demonstrating that defendants failed to review or check information that they had a duty to monitor, or ignored obvious signs of fraud."); *Moody's*, 599 F. Supp. 2d at 515 ("Plaintiff's allegations are sufficient to show that McDaniel had 'information suggesting that their public statements were not accurate.' These allegations are sufficient to allege that McDaniel had the requisite scienter.").

Moreover, the Complaint demonstrates that the Individual Defendants were the Company's designated representatives for communicating with the market about Freddie's operations. In numerous conference calls and other presentations, they spoke thoroughly and intelligently with market analysts, often responding to complex questions about the Company's mortgage portfolio, capital position, and related financial results. *See, e.g.*, ¶¶445-49, 459-63. Given their role as Company spokespersons who made the misrepresentations here, it is "exceedingly unlikely" that the Individual Defendants were "unaware of the problems" effecting the Company and were "merely

repeating lies fed to [them] by other executives of the company." *Tellabs II*, 513 F.3d at 711; *In re Wash. Mut., Inc. Sec.*, 2009 U.S. Dist. LEXIS 99727, at *22 (W.D. Wash. Oct. 27, 2009) ("Killinger's own statements about risk management show his detailed knowledge about the processes. These allegations show his actual knowledge of the risk management problems of which Plaintiffs complain.").

(4) Post-Class Period Events

Ignored by Defendants, Plaintiffs' inferences of scienter are extensively supported by numerous post-Class Period events revealing known contemporaneous facts corroborating Defendants' wrongful conduct. In the Second Circuit, a plaintiff may "rel[y] on post-class period data to confirm what a defendant should have known during the class period." *In re Scholastic*, 252 F.3d at 72. Indeed, to hold otherwise would reward Defendants for "their successful concealment of their wrongdoing." *Vivendi Universal*, 381 F. Supp. 2d at 181 ("To accept defendants' reasoning, I should reward them for their successful concealment of their wrongdoing, which for the most part did not come to light until those in control of Vivendi resigned and lost the ability to further conceal the true extent of Vivendi's financial woes.").

Here, the Complaint cites to, and incorporates by reference, numerous post-Class Period facts revealing serious problems existing at the Company that were known or should have been known by Defendants. These include: (1) forced resignations and/or terminations of the Individual Defendants and several members of Freddie's board by the government; (2) Congressional testimony based, in large part, on review of thousands of non-public Freddie documents, which corroborated that Freddie grossly understated its risk exposure to non-prime loans and grossly overstated its capital adequacy;[26] (3) investigative news reports, which publicly revealed that Freddie ignored repeated

[26] Defendants attempt to downplay the weight of the Congressional testimony as nothing more than "criticisms of the GSEs by longtime political opponents." Def. Mem. at 36. This factually driven "defense" is premature. Defendants may challenge the credibility or motives of various adverse witnesses at summary judgment or trial, not at the motion to dismiss stage. *Goldman v. Belden*, 754 F.2d 1059, 1067 (2d Cir. 1985) ("The court's function on a Rule 12(b)(6) motion is not to weigh the evidence that might be presented at a trial but merely to determine whether the complaint itself is legally sufficient."). And while they label such

warnings to reduce or otherwise eliminate its non-prime loan exposure and boost its capital cushion; (4) highly publicized investigations initiated by the SEC, the FBI and other governmental agencies into Defendants' misconduct;[27] (5) billions of dollars in additional governmental bailouts to stem the damage caused by losses attributable to defaulting non-prime and non-traditional loans; and (6) a March 2009 filing by the Company where it reported, for the first time, an additional $164.3 billion in subprime loans relating to borrowers with FICO scores between 620-659. ¶¶23-24, 26, 97, 123-24, 163, 165-66, 298-12, 564.

Because "Defendants provide nothing to impugn the veracity of these post-dated" sources, they are more than sufficient to support an inference of scienter. *Vivendi Universal*, 381 F. Supp. 2d at 181; *In re Sipex Corp. Sec. Litig.,* 2005 WL 3096178, at *1 (N.D. Cal. Nov. 17, 2005) (finding a strong inference of scienter and reasoning sweeping internal reforms are "strong medicine" because "[s]uch house-cleaning and reforms do not follow innocent mistakes. Rather, they customarily, even if not invariably, follow systemic and fraudulent abused of internal financial controls."); *Plotkin v. IP Axess Inc.*, 407 F.3d 690, 698 (5th Cir. 2005) ("For example, the fact that a business files for bankruptcy on 'Day Two,' may, under the right surrounding circumstances, provide grounds for inferring that the business was performing poorly on 'Day One.'); *In re Read-Rite Corp. Sec. Litig.*, 335 F.3d 843, 846 (9th Cir. 2003) ("A later statement may suggest that a defendant had contemporaneous knowledge of the falsity of his statement, if the later statement directly contradicts or is inconsistent with the earlier statement.").

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testimony as "the gratuitous comments of outsiders," Defendants conveniently ignore that many witnesses testified ***only after reviewing scores of internal Freddie documents contradicting Defendants' public statements*** – documents to which Plaintiffs are not privy due to the PSLRA's discovery stay. *See* Exh. C.

[27] Contrary to Defendants' assertion that "governmental investigations also fail as a matter of law to raise an inference of scienter" (Def. Mem. at 37), "[c]ourts commonly hold that pending government investigations are relevant and provide notice of a possible fraud, *i.e.*, that the pendency of an investigation serves to suggest that a fraud may have occurred and may not be ignored." *See, e.g., Eastwood Enters., LLC v. Farha*, 2009 U.S. Dist. LEXIS 88945, at *13-14 (M.D. Fla. Sept. 29, 2009).

(5) The Magnitude of the Fraud

Courts in this circuit and elsewhere have held that "the magnitude of the alleged fraud provides some additional circumstantial evidence of scienter." *Katz*, 542 F. Supp. 2d at 273. Indeed, the magnitude of the fraud is properly "considered in weighing whether the Complaint meets the pleading standard for scienter" because "all other things being equal, more opportunities should exist to discover a larger fraud than a smaller fraud." *In re Livent, Inc. Sec. Litig.*, 78 F. Supp. 2d 194, 217 (S.D.N.Y. 1999).

In this case, Plaintiffs allege that, as a result of Defendants' fraudulent conduct, Freddie understated the size of its non-prime and non-traditional loan holdings and overstated the amount of its capital position by ***billions and billions of dollars***. Given these huge numbers, Defendants can hardly claim that they were unaware of the true nature of their misstatements. *In re Telxon Corp. Sec. Litig.*, 133 F. Supp. 2d 1010, 1030 (N.D. Ohio 2000) ("The more serious the error, the less believable are defendants['] protests that they were completely unaware of [the company's] true financial status and the stronger is the inference that defendants must have known about the discrepancy."); *In re RAIT Fin. Trust Sec. Litig*., 2008 WL 5378164, at *13 (E.D. Pa. Dec. 22, 2008) ("[T]he sheer size of the impairment eventually taken by RAIT adds to the inference that the Officer Defendants and Defendant RAIT by imputation must have had some awareness that the problem was brewing.").[28] One need look no further than the vast sums of bailout money propping up Freddie to appreciate the magnitude of Defendants' fraud.

d. The Complaint Sufficiently Pleads Scienter as to Freddie

Lastly, the Second Circuit recently indicated a plaintiff may "raise the required inference with regard to a corporate defendant without doing so with regard to a specific individual

[28] While, as the Individual Defendants correctly state, GAAP violations, standing alone, are insufficient to establish scienter, "when the number, size, timing, nature, frequency, and context of the misapplication or restatement are taken into account, the balance of the inferences to be drawn from such allegations may shift significantly in favor of scienter." *In re MicroStrategy, Inc. Sec. Litig*., 115 F. Supp. 2d 620, 635 (E.D. Va. 2000).

defendant." *Teamsters Local 445 Freight Div. Pension Fund v. Dynex Capital, Inc.*, 531 F.3d 190, 195 (2d Cir. 2008); *Tellabs II*, 513 F.3d at 710 ("[I]t is possible to draw a strong inference of corporate scienter without being able to name the individuals who concocted and disseminated the fraud."). This would arise in situations where, like here, a company's internal practices are so far out of line with the company's public statements. *Tellabs II*, 513 F.3d at 710 (court found that "a strong inference of corporate scienter" would be pled where "so dramatic an announcement" about the company's affairs "would have been approved by corporate officials sufficiently knowledgeable about the company to know that the announcement was false."); *New Century*, 588 F. Supp. 2d at 1230 ("The allegations are sufficient to infer a deliberately reckless set of statements telling the public one thing when New Century was doing something quite different--the loans were of poor, not great, quality; the underwriting was all but absent, not strict; and the internal controls were slack rather than searching.").

Here, the Complaint details a staggering disconnect between Defendants' Class Period public statements and Freddie's internal operations. In addition to particularized confidential witness statements, the Complaint quotes numerous other sources, all revealing the alarming level of misconduct occurring at Freddie.[29] These sources identify numerous high-ranking executives at

[29] Defendants do not dispute that particularized allegations of former employees "add to the inference of scienter" required under the PSLRA. *See, e.g.*, *In re Lernout & Hauspie Sec. Litig.*, 208 F. Supp. 2d 74, 87 (D. Mass. 2002). Yet, Defendants go to great lengths to denigrate Plaintiffs' use of confidential witnesses. Def. Mem. at 32-35. In so doing, they misstate the law. *See Tellabs II*, 513 F.3d at 711-12 (Seventh Circuit limited reach of prior holding that scienter allegations based on confidential witnesses should be "discounted"). They also raise fact-based arguments going to the credibility of Plaintiffs' confidential witnesses, not whether they are properly identified. *See, e.g.*, *Fitzer v. Sec. Dynamics Techs., Inc.*, 119 F. Supp. 2d 12, 21 (D. Mass. 2000) (questions concerning the credibility of unnamed sources "are questions that go to the weight of the[] evidence"). While these witnesses may not have directly interacted with the Individual Defendants, it does not follow that their accounts must be discounted. These witnesses describe, based on personal knowledge, operations at Freddie that were completely at odds with Defendants' public statements. In turn, they describe numerous "red flags" that Defendants, at a minimum, recklessly disregarded. As such, these witness accounts, which are corroborated by each other and by other sources described in the Complaint, meaningfully contribute to the scienter calculus. *In re Cabletron Sys., Inc.*, 311 F.3d 11, 30 (1st Cir. 2002) ("Overall, the accumulated amount of detail the sources provide tends to be self-verifying; these are not conclusory allegations of fraud, but specific descriptions of the precise means through which it occurred, provided by persons said to have personal knowledge of them. In addition, the number of different sources helps the complaint meet the standard. Their consistent accounts reinforce one another and

Freddie who orchestrated the efforts to implement programs designed to encourage non-prime and non-traditional loan purchases and to compromise Freddie's underwriting and quality control processes as part of that effort. Accordingly, these collective facts are more than sufficient to establish scienter on the part of Freddie, even if the Court finds scienter lacking as to the Individual Defendants. *Moody's*, 599 F. Supp. 2d at 516 ("Plaintiffs allege other statements indicating that Moody's was cognizant that its public representations did not conform to reality. . . . They have alleged specific statements indicating that various top officials knew that Moody's independence, ratings, and methodology had been comprised. Consequently, the allegations of the AC sufficiently plead Moody's scienter."); *JPMorgan Chase*, 363 F. Supp. 2d at 627 ("[N]othing in Rule 9(b) or the PSLRA requires a plaintiff to allege that the same individual who made an alleged misstatement on behalf of a corporation personally possessed the required scienter . . . . Plaintiffs have alleged the existence of specific JPM Chase communications that indicate that JPM Chase officers, including the Vice Chairman, a Vice President and a Managing Director, had knowledge that the Mahonia transactions were not bona fide trades. That knowledge may properly be attributed to the corporate defendant.").

Under *Tellabs*, the Court must view Plaintiffs' allegations cumulatively and holistically to determine whether they sufficiently allege a strong inference of scienter. 551 U.S. at 325-26. That said, even if, as Defendants claim, allegations of motive or recklessness may be individually inadequate, the Court should conclude that, when considered collectively, they are more than sufficient to survive dismissal at this stage of the proceedings.

e. Defendants' Competing Inference Is Not More Plausible

Falling back on a familiar refrain, Defendants submit that "the facts give rise to a far stronger inference that investor losses resulted from, not from any fraud, but rather from the historically unprecedented decline in the housing market." Def. Mem. at 40. This, quite frankly, rings hollow.

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undermine any argument that the complaint relies unduly on the stories of just one or two former employees, possibly disgruntled.").

Freddie's "mission" was based on its ability to understand and address the numerous risks involved in the residential mortgage market. As such, it had a responsibility to its customers, its shareholders and to the U.S. economy to be at the forefront of any real or perceived crisis. As extensively detailed in the Complaint, Freddie completely failed in its mission, and Defendants' subsequent attempts to place the blame elsewhere are simply not plausible. *In re MoneyGram Int'l, Inc.*, 626 F. Supp. 2d 947, 982-83 (D. Minn. 2009) ("[T]he complaint's factual allegations are subject to two competing narratives. Both narratives accept that the market for subprime and Alt-A ABS was in turmoil during the class period and eventually froze . . . . [T]he court determines that, in consideration of the totality of the circumstances, and with particular emphasis on the alleged misrepresentations and omissions, a reasonable person could find lead plaintiff's fraud narrative to be cogent and as plausible as defendants' opposing nonfraudulent narrative."); *New Century*, 588 F. Supp. 2d at 1230 ("The inference of deliberate recklessness as to false statements regarding loan quality and underwriting is at least as compelling as inferring that the Officer Defendants were simply unaware of New Century's practices when the statements were made, or taken by surprise when the market took an unexpected turn for the worse.").

C. Plaintiffs State a Claim for Violations of §20(a)

Defendants contend Plaintiffs' §20(a) claim should be dismissed because Plaintiffs fail to plead: (1) a primary violation under §10(b); and (2) their culpable participation in the fraud. Def. Mem. at 60; I.D. Mem. at 23-25. This is meritless. Without rehashing the arguments discussed above, Plaintiffs have alleged primary violations under §10(b), including sufficient allegations that the Individual Defendants acted with the requisite scienter and actually controlled Freddie's operations. Accordingly, the Court should sustain Plaintiffs' control person liability claims under §20(a). *See, e.g.*, *Katz*, 542 F. Supp. 2d at 275-76.

IV. CONCLUSION

As discussed herein, Plaintiffs have pled their claims pursuant to §§10(b) and 20(a) of the Exchange Act consistent with Rule 8, Rule 9(b) and the PSLRA. Accordingly, Defendants' motions to dismiss should be denied in their entirety.

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